

Polaroid
PDC 3370



the
CHARACTER
group plc

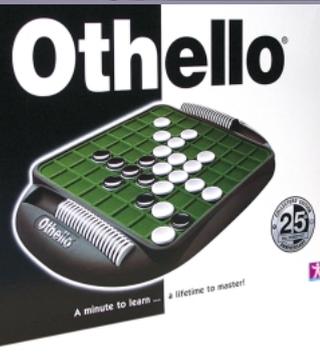
annual report and accounts
for the year ended 31 August 2003



digital



gifts



games



toys

AUTO FOCUS 3X OPTICAL ZOOM
5.8mm

Product update

DIGITAL PRODUCTS

PDC 4350

Polaroid PDC 4350 targets mainstream consumers who seek an easy-to-use digital camera with a broad range of features. It shoots at 4.1 million pixels with 3x optical zoom and 2x digital zoom.



ION 230

The iON 230 uses a 2.1 million pixel sensor. Accompanied by the Polaroid DockiT, the iON 230 lets you simply place your camera in the dock and instantly transfers images to your PC.



PDC 3030

Ergonomically designed and great value for money! 4-in-1 functions: still images, video clips, web cam and audio recorder. PDC 3030 comes with 3.0 million pixel resolution and 3x digital zoom.



AQ 3100

The AQ 3100 is a digital camera for all weather conditions. This new digital camera comes with a waterproof case so you can dive up to 30 meters and shoot at 3 million pixels.

TOYS

CLIFFORD

The Clifford range of toys is based on the pre-school cartoon series, "Clifford the Big Red Dog". Pictured here is popular Rollover Clifford; clap your hands and he will do just that!



KELLOGGS CEREAL BAR MAKER

A new introduction for 2004. Cereal Bars are a popular part of kids lunch boxes and now they can create their own. All sorts of delicious recipes included!



4-EVER BEST FRIENDS

Building on the themes of friendship and sharing, these beautifully detailed, collectable fashion dolls are sold in pairs and include charm bracelets for little girls to give to each other.



STRAWBERRY SHORTCAKE

Strawberry Shortcake and her friends believe things are growing better all the time! Character Options has designed a range of dolls and interactive playsets. Each character has its own sweet scent.

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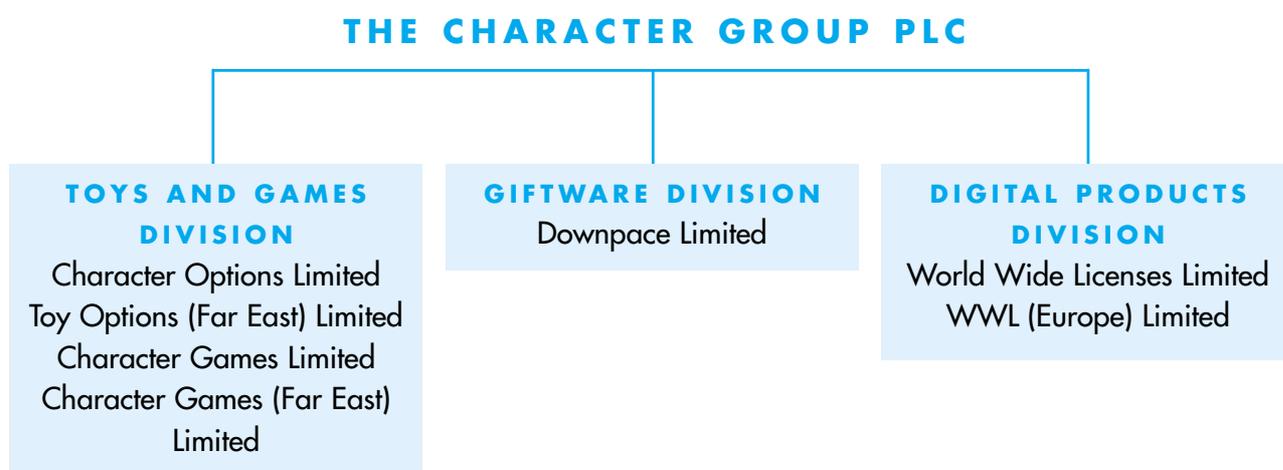
DIRECTORS AND ADVISERS

<i>Directors</i>	<i>Registered office</i>	<i>Stockbrokers</i>	<i>Registrars</i>
R King	5th Floor	Collins Stewart Limited	Neville Registrars Limited
E Preziosi	4 Chiswell Street	9th Floor	Neville House
K P Shah	London EC1Y 4UP	88 Wood Street	18 Laurel Lane
J J P Kissane		London EC2V 7QR	Halesowen
J J Diver	<i>Solicitors</i>		West Midlands B63 3DA
I S Fenn	Duane Morris		
Lord Birdwood	5th Floor	<i>Bankers</i>	
A G Horvat	4 Chiswell Street	National Westminster Bank plc	
	London EC1Y 4UP	Standard Chartered Bank plc	
<i>Secretary</i>		The Hongkong and Shanghai Banking Corporation Limited	
K P Shah FCCA	<i>Auditors</i>	Banca Nazionale del Lavoro S.p.A.	
	Baker Tilly	KBC Bank N.V.	
<i>Company registration number</i>	Registered Auditors & Chartered Accountants		
3033333	Marlborough House		
	Victoria Road South		
	Chelmsford		
	Essex CM1 1LN		

HIGHLIGHTS

- Turnover up 45% to £85m
- Profit before tax up 284% to £5.8m
- Basic earnings per share up 341% to 13.5p
- Digital products now account for 40% of Group sales
- Proposed final dividend – 2.0 pence
Total dividend – 3.0 pence

GROUP STRUCTURE



I am delighted to report that for the year under review, we have not only made significant advances in many aspects of the business but, we have maintained the improvement in trading reported for the first half and almost quadrupled our profitability for the year as a whole.

The year has been very demanding for all businesses and the current outlook would appear to suggest that, if anything, we have to be prepared for even more challenging times ahead. We are a very different Company today than we were only two years ago. At that time the vast majority of turnover was made up from the distribution of third party products whereas, by the end of 2004, we anticipate that 70% of sales will derive from products developed in-house. The Board believes that the Group is better positioned to meet these challenges than in previous years.

Within the Group, all divisions are consistently increasing the speed at which new product development is undertaken and it is important to note that, with the exception of tooling which is either depreciated over 12 months or in the financial year that the product is introduced to the business, all associated costs of development are expensed as they occur. As these costs are growing year on year and are always accounted for before the benefit of any sales, they are inevitably impacting on profits at an early stage.

Our development programme is changing the nature of our business. As we build our intellectual property rights portfolio, we are adding value to the businesses and opening up more opportunities for growth, both domestically and internationally, across the Group.

By the end of 2004, we expect that 50% of Group sales will be made up of digital products (2003: 40%), with the balance coming from toys, games and gifts, and International sales will grow from 39% to close to 50% of Group turnover.

It is this change of strategy and direction that gives us confidence that, notwithstanding the short-term difficulties in the marketplace, we shall continue to improve our position in the UK market, our world-wide distribution and our profitability.

Results

Profit before tax was £5.82 million (2002: £1.52m), an increase of 284% over 2002 on sales of £85.31 million. (2002: £58.94 million).

Overheads remained under tight control representing 13.7% of sales (2002: 19.0%), whilst gross margins dropped 2.6 percentage points reflecting in particular the increased level of digital and international sales at lower margins.

Operating profits at £6.39m (2002: £2.08m) were higher by 207%.

During the year, stocks increased by £3.16m reflecting the increased trading levels.

Cash at bank at 31 August 2003 improved to £3.93m (2003: £3.28m).

The Group had unused bank facilities of £1.86 million. Net assets improved by 127% to £5.60m.

Dividend

Restoration of the dividend for the half year clearly demonstrated the Board's confidence in the future trading performance of the Group. I am therefore pleased to inform shareholders that the Board is proposing, subject to approval at the Annual General Meeting on 21 January 2004, a final dividend of 2.0 pence per share. This, together with the interim of 1.0 pence per share makes a total of 3.0 pence per share for the year. The dividend is covered 4.2 times by earnings.

The final dividend will be paid on 30 January 2004, to shareholders on the Register as at 9 January 2004.

Review

The financial year to 31 August 2003 has seen a number of significant achievements across the business with both our own new developed and branded new ranges, together with sourced third party products, being added to our already successful existing collection. The business has produced more balanced sales across its portfolio of products.

The Toy and Games Division Character Options Limited and Character Games Limited

This division has produced a very solid performance which is even more satisfying as the results have been achieved across a broad range of good product, much of which was derived from our own development. Ready Steady Cook, Clifford and Wheels on the Bus are good examples for toys and Slapz, Hungry Huey, Pin the Tail on the Donkey and the perennial Spin the Bottle, now in its seventh year, are similar examples for games.

Distributed products worthy of mention include: Mighty Beanz, Scooby-Doo, Magic Sand, Radio control in general (with the Hovercraft proving to be the star performer), Intellivision (a multi games TV console) and Neopets which continue to sell well.

Since the year-end, I am pleased to announce that we have been appointed the exclusive distributor for what we believe will be the best single product available in the market for 2004. Robosapien, is a unique personality featured robot, which is capable of performing amazing tasks, including dance, karate, picking up and throwing items, burping, whistling or simply standing guard listening for intruders! We shall be selling in Robosapien for Christmas 2004 and presenting it to the trade at The International Toy & Hobby Fair in London at the end of January next year. We believe that this product will achieve significant sales in the 2004 calendar year and we look forward to reporting on its progress at the half year stage.

We have also secured a number of other exciting opportunities which provide the Toy and Games business with excellent opportunities for growth. These include an agreement with MGA Entertainment Inc., which gives Character Options the exclusive UK distribution rights for several new licensed toy lines, including the 4-Ever Best Friends doll line, for which we have particularly strong hopes for the 2004 calendar year, as well as the Land/Sea radio control, which was a top seller in the US and recipient of a toy industry award in 2003, and a range of Spiderman 2 toys. In addition, we have agreed a contract with Universal Studios Consumer Products Group Europe, which provides us with control of the UK

distribution for the master toy line of products produced in conjunction with the film Dr. Seuss' The Cat in the Hat, which will be released in the UK early next summer.

As part of the return of retros, we have secured the master license for one of the best-known characters from the 1980's, Strawberry Shortcake. The license agreement with Those Characters From Cleveland, Inc., owned by American Greetings, allows us to manufacture and distribute a range of toys, including the all important doll licence. The complete product range has been successfully developed in-house and we are already enjoying positive feedback from our customers and expect steady sales to follow from this range, both in the UK and internationally.

Another exciting new product is the development of a children's cereal bar maker, which is currently nearing completion. It will be sold under license of the Kelloggs brand and we believe, will have world-wide appeal.

We are also developing a range of fashion craft toys for girls and a craft range for boys to gain representation in the newly rejuvenated hobby sector where we shall be looking to create two new brands.

We are working with Giochi Preziosi S.p.A. ("Giochi Preziosi"), one of Italy's leading designers, distributors and retailers of toys and related products, to distribute their products in the UK as well as to develop product lines for the future and together, look for greater international opportunities. We are already working together with Giochi Preziosi and some of our major UK customers to develop and supply them with their own-brand products.

Overall, we believe that the strength of our own developed products, when combined with the increased strength of our distributed range, will enable this division to achieve another satisfactory year.

The Giftware Division Downpace Limited

Downpace, which has been operating all year in a difficult trading environment, has produced a satisfactory performance in the year ended August 2003.

Throughout the course of the financial year, this division, under its new management, has principally focussed on expanding its customer base and further developing its range of generic giftware products, including 'light-up' pens, beer bottle holders, novelty gel pens, mini photo frames and feathered mirrors. We are delighted that such ranges have proved to be popular with our customers, particularly in the greeting card market and we shall be strengthening our generic offering during 2004.

Licences that have continued to perform well during the course of the year include, The Simpsons, Lord of the Rings (Two Towers) and Hug Displays, with products including SpongeBob Squarepants, The Dog, Barbie, and Candy Shot Glasses.

The Dog, SpongeBob Squarepants and Barbie, are enjoying encouraging 'repeat business' and Hand Painted Glasswear is proving to be particularly popular to the consumer in the run up to Christmas 2003.

The recent appointment of a Business Development Manager (sales) and the expansion of the product development team,

is intended to ensure that the business delivers new products and concepts to attract a wider and more diversified customer base.

The gift market, like the retail market in general, has been difficult yet we are confident that the changes we are making to both our product line up and the focus of our distribution will begin to have a real effect in 2004.

The Digital Products Division **World Wide Licenses Limited ("WWL")**

The strong performance reported at the interim stage within our Digital Division continued in the second half and is reflected in the improved sales of the Group's digital camera ranges produced both under our own brand Cool-iCam® and under the Polaroid® brand, with the latter already being exported to over 30 countries. In addition, our sales of OEM products in both Germany and Japan continued to be strong.

Sales of digital products increased from 25% at the half year stage to 39% of Group sales by the year-end. In real terms, they grew by 137%. Since entering the market in June 2000, WWL has rapidly become a major world-wide supplier with total shipments of digital cameras being well in excess of two million units.

In March 2002, WWL invested in a Research and Development Centre in Shenzhen, China. Today, it has over 30 certified engineers and WWL is now regarded as a true system integrator of technology. With the technology for the digital camera category changing so rapidly, it became clear that WWL had to acquire the technology directly from leading semi-conductor companies in the USA and

Japan. This technology has enabled WWL to further develop its products and subsequently transfer the technology in 'production-ready form' to OEM manufactures in Southern China.

In the financial year to 31 August 2003, WWL launched over 20 products under the Polaroid Brand and the Polaroid PDC2070, which was our first camera fully developed by our own engineering team, has sold over 250,000 units in Europe and Asia alone. In 2004, we will be introducing further upgrades to our existing line and also introducing some very exciting technology in the imaging sector which will allow WWL to strengthen its position as a major innovator and supplier to the digital camera market.

Our aim was to achieve a 5% market share and we have already exceeded this in the UK & Japan and we expect to achieve an equivalent share in a number of other countries in 2004. Our goal, which is aggressive but achievable, is to have a world-wide 5% market share by the end of 2005, and a target production of over 100,000 units per month being achieved by the end of 2004.

We have of course to be aware that this business has its own unique challenges that have to be overcome on a regular basis by the management. For example, some of the expectations for the major brands have recently been downgraded due to current shortages of memory chips and other components. We are managing both the difficulties and our expectations to ensure that our growth pattern can continue.

Shareholdings

There have been several significant shareholder transactions that have taken place during the course of the year, all of which have been subject to announcements under our statutory obligations.

Following the changes in shareholdings, the Directors have an interest of 61.46% in the Character Group which, through its representation on the Board, includes Giochi Preziosi's holding of 26.25%. The balance of the issued shares, representing approximately 38.54%, being held by private shareholders and institutional investors.

The Directors are aware that greater liquidity in the market would encourage institutional support and will act to improve liquidity as the opportunities arise.

People

During the year we have witnessed many significant achievements across the Group and these are principally due to the hard work and commitment of our dedicated workforce. On behalf of all of the Directors and shareholders, I would like to take this opportunity to thank all our employees, both in the UK and overseas, for their hard work and contribution to this excellent result.

Web-Site

The development of a Group website has recently been undertaken by our own personnel and the first phase will go live later today and will be developed further in due course to provide more in depth information on our group companies and their products.

The site can be found on www.charactergroup.plc.uk.

Prospects and Summary

Our product portfolio continues to strengthen, our distribution base continues to widen, our balance sheet continues to strengthen and, with many new exciting additions to our product ranges, we expect to build upon our position in 2004, and achieve another satisfactory performance.



Richard King
Chairman

DIRECTORS' BIOGRAPHIES

Richard King (aged 58), Executive Chairman, has extensive experience in the toy industry and has been involved in importing consumer products from the Far East since 1969. He established the original business of The Character Group plc jointly with Mr Kissane and Mr Shah in 1991 and works in close association with the management of each division to develop and implement Group strategies.

Enrico Preziosi (aged 55), Chief Executive Officer and Managing Director, was appointed to the Board as a Non-Executive Director in August 2000 and as Chief Executive and Managing Director in May 2001. He is the Chairman of, and is interested in a majority of the issued shares of, Giochi Preziosi S.p.A. He founded Giochi Preziosi S.p.A. in 1984 and has since been instrumental in growing its business.

Kiran Shah (aged 49), Group Finance Director, is a member of the Chartered Association of Certified Accountants. After initially working in private accountancy practice, he moved into industry and since 1978 has been involved extensively in the toy industry, notably in his role in jointly heading up a successful management buyout of Merit Toys Limited in 1981 and its subsequent sale to Bluebird Toys plc in 1988. He jointly established the original business of The Character Group plc with Mr King and Mr Kissane in April 1991.

Joe Kissane (aged 51), Managing Director of Character Options Limited, has considerable sales expertise in and outside of the toy industry, gained over a period of 30 years, notably with such companies as Nabisco, Lego and Tonka. He is one of the founders of the Group.

Jon Diver (aged 39), Group Marketing Director, joined the Group in September 1991 from Rainbow Toys Limited, where he was Senior Marketing Executive. He became Group Marketing Director in August 1994, and has developed close working relationships with the Group's suppliers. He has played a key role in the development and implementation of the Group's marketing strategy.

Ian Fenn (aged 60), Senior Independent Non-Executive Director, joined the Board in May 1995. He has extensive experience in corporate finance gained over many years in stockbroking and merchant banking in the City of London. He is a Director of ARM Corporate Finance Limited which is authorised and regulated by the Financial Services Authority Limited.

Lord Birdwood (aged 65), Independent Non-Executive Director, was appointed to the Board in September 1995. He has experience as a Director of quoted and private companies. He has particular interests in executive placement and recruitment.

Aldo Horvat (aged 61), Non-Executive Director, was appointed to the Board in November 2002. He is a consultant to Giochi Preziosi S.p.A. and has considerable experience in the toy industry gained over more than 30 years.

REPORT OF THE DIRECTORS

The directors present their report together with the accounts for the year ended 31 August 2003.

Directors

The following are the directors that served during the year:

- Richard King (Executive Chairman)
- Enrico Preziosi (Chief Executive Officer and Managing Director)
- Kirankumar Premchand Shah FCCA (Group Finance Director)
- Joseph John Patrick Kissane (Managing Director, Character Options Limited)
- Jonathan James Diver (Group Marketing Director)
- Ian Stanley Fenn (Senior Independent Non-Executive Director)
- Lord Birdwood (Independent Non-Executive Director)
- Aldo Gianfranco Horvat (Non-Executive Director – appointed 29 November 2002)
- Maurizio Ferdinando Vincenzo Cellai (Non-Executive Director – resigned 29 November 2002)

Biographies of the directors are set out on page 8.

Principal activity

The Group is engaged in the design, development and international distribution of digital cameras, toys, games and giftware.

Business review, results and dividend

A review of the business is contained in the Chairman's Statement on pages 3 to 7 and the results are detailed in the consolidated profit and loss account on page 20, the consolidated balance sheet on page 21 and the consolidated cash flow statement on page 23. There was a profit for the year, after taxation, amounting to £5,536,000.

An interim dividend of 1.0p per share was paid on 25 July 2003. The directors recommend a final dividend of 2.0p per share making a total dividend of 3.0p per ordinary share (2002: nil). If approved, the final dividend will be payable on 30 January 2004, to shareholders on the register on 9 January 2004.

Directors and their interests in shares

The directors and their interests (all of which are beneficial) in the shares of The Character Group plc are:

Directors	31 August 2003		31 August 2002	
	Number of ordinary shares	Ordinary shares under option	Number of ordinary shares	Ordinary shares under option
R King	5,270,428	–	5,770,428	–
E Preziosi	11,885,898	–	11,885,898	–
K P Shah	5,620,000	–	5,620,000	–
J J P Kissane	1,462,300	185,000	1,662,300	100,000
J J Diver	1,690,640	185,000	1,690,640	100,000
I S Fenn	9,000	–	9,000	–
Lord Birdwood	8,750	–	8,750	–
A G Horvat	–	–	–	–
TOPS Pension Scheme*	1,600,000	–	1,600,000	–

(*each of R King, K P Shah and J J Diver is a trustee and a beneficiary under such pension scheme arrangements.)

There were no other changes in the directors' beneficial interests between 31 August 2003 and 24 November 2003.

Included in the interests of R King are his interests in shares held by Cedarberg Investments Limited, being 1,885,428 ordinary shares at 31 August 2003 and at 31 August 2002. There is also included in the interests of R King his interests in shares held by his spouse, Mrs M H King, being 320,000 shares at 31 August 2003 and at 31 August 2002.

Included in the interests of E Preziosi are his interests in shares held by Giochi Preziosi S.p.A., being 11,885,898 ordinary shares at 31 August 2003 and at 31 August 2002.

REPORT OF THE DIRECTORS CONTINUED

Included in the interests of K P Shah are his interests in shares held by Sarissa Holdings Limited, being 5,620,000 ordinary shares at 31 August 2003 and at 31 August 2002.

Further, Orbis Pension Trustees Limited, the trustee of the Company's employee share ownership trust ("the Trust"), held 285,000 ordinary shares at 31 August 2003 and at 31 August 2002. Each of R King, K P Shah, J J P Kissane and J J Diver is deemed to be interested in such holding by virtue of being within the class of beneficiaries defined by the Trust.

Pursuant to the requirements of their appointment letters, Lord Birdwood, Mr Fenn and Mr Horvat retire at the Annual General Meeting and, being eligible, offer themselves for re-election.

Employment policies

The Group depends on the skills and commitment of its employees in order to achieve its objectives. Group staff at every level are encouraged to make their fullest possible contribution to the Group's success.

The Group's selection, training, development and promotion policies ensure equal opportunities for all employees regardless of gender, marital status, race, age or disability. All decisions are based on merit.

It is the Group's policy not to discriminate between employees or potential employees on any grounds. Full and fair consideration is given to the recruitment, training and promotion of disabled people and should staff become disabled during the course of their employment, efforts would be made to provide appropriate re-training. The Group places enormous importance on the contributions of its employees and aims to keep them informed of developments in the Group by way of regular meetings, newsletters and publications, together with distribution of the Annual Report.

Employees are encouraged to become involved in the financial performance of the Group through the share option schemes.

Research and development

The Group's research and development activities are concentrated on the development of new products, new processes and improvements of existing products.

Policy and practice on payment of creditors

The Group does not follow any standard code of practice for paying its suppliers but, instead, agrees with each principal supplier the terms of payment for each transaction or series of transactions. The Group's policy is then to abide by those pre-arranged terms for payment. At 31 August 2003, trade creditors of the Group represented an average of 70 days credit in relation to total purchases for the year.

Statement of directors' responsibilities

We are required under company law to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Group and the Company, and of the Group profit or loss for that year.

In preparing these accounts we are required to:

- select suitable accounting policies and apply them consistently
- make reasonable and prudent judgements and estimates
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts
- prepare the accounts on a going concern basis unless, in our view, the Group and the Company will be unable to continue in business.

We are also responsible for:

- keeping proper accounting records
- safeguarding the Group's and the Company's assets
- taking reasonable steps for the prevention and detection of fraud.

Substantial shareholders other than directors

At 24 November 2003 the following, other than the directors and their family interests, had notified the Company of an interest in 3% or more of the Company's ordinary shares:

Name	Number of ordinary shares	Shareholding %
Sweet Briar Investments Limited	1,875,000	4.14

REPORT OF THE DIRECTORS CONTINUED

Post balance sheet event

On 11 November 2003, the Company issued and allotted 4,000,000 new ordinary shares of 5p each in the Company to Valtidone S.p.A., the holder of the Company's £4,600,000 (nominal) convertible loan note, following a partial exercise by Valtidone S.p.A. of its rights of conversion in respect of £1,600,000 (nominal) of the loan note. On 17 November 2003, the 4,000,000 new ordinary shares allotted to Valtidone S.p.A. were admitted to the Official List and to trading on the London Stock Exchange's market for listed securities. Further information is set out in note 29 to the accounts. The Company received a notification from Valtidone S.p.A. on 24 November 2003 of its sale of the 4,000,000 new ordinary shares. Valtidone S.p.A. no longer holds any interest in issued shares in the capital of the Company.

Share option schemes

Details of the share option schemes are given in note 18 to the accounts.

Charitable and political donations

Payments of a charitable nature made during the year amounted to £28,000 (2002: £2,000). There were no political contributions.

Annual General Meeting

Notice convening the ninth annual general meeting of the Company is set out on pages 39 to 41 of this document. Full details of the business to be transacted at that meeting is set out in that notice. The business of the meeting will include special business proposing the consideration of resolutions to:

- renew the directors' general authority to allot unissued shares in the capital of the Company up to an aggregate nominal amount of £688,132. This authority will expire on which ever is the earlier of the conclusion of the annual general meeting of the Company to be held in 2005 or the date falling 15 months following the passing of this resolution. The directors have no present intention of exercising this authority which represents approximately 33.3% per cent of the issued share capital of the Company at 31 August 2003;
- authorise the directors to offer to allot shares to shareholders who elect to accept the same in lieu of any cash dividend entitlement;
- authorise the directors to make purchases of the Company's issued ordinary shares in the market for cancellation, if and when the directors consider that it would be in the best interest of the Company and shareholders generally to do so, up to 6,790,000 shares (representing approximately 15 per cent of the current issued share capital of the Company). The price at which an ordinary share in the Company may be purchased in exercise of this authority is subject to a maximum price of 105% of the average middle market values of an issue share in the Company in the five business days prior to purchase and a minimum of 5p, being the nominal value of an issued share in the Company. There is no present intention on the part of the directors to exercise this authority. If all subsisting options granted by the Company (as particularised in note 18 to the accounts) were exercised and the balance of the loan note referred to in note 14 to the accounts was converted a total of 9,841,250 of new ordinary shares would be allotted, representing approximately 17.85% of the enlarged issued share capital of the Company following such exercise and conversion. If the authority proposed for the buy back of shares by the Company was to be exercised in full, then the number of shares to be issued on exercised and conversion of these entitlements would constitute 20.36% of the issued share capital as enlarged by such allotments of shares;
- approve a disapplication of shareholder pre-emption rights to enable the issue of equity securities in connection with any rights issues made by the Company, with certain adjustments to shareholder entitlements to be made for practical purposes to deal with fractional entitlements and overseas restrictions on offers of shares in UK companies and a further limited disapplication of those pre-emption rights on the allotments for cash of up to and aggregate nominal amount of £103,220, representing approximately 5% of the nominal value of the issued ordinary share capital of the Company as a 31 August 2003.

Auditors

A resolution to re-appoint Baker Tilly as auditors to the Company will be proposed at the Annual General Meeting.

Corporate Governance Statement

The directors have considered the provisions set out in the Principles of Good Governance and Code of Best Practice (“the Combined Code”) appended to the Listing Rules of the Financial Services Authority.

Directors

The Board of directors comprises five executive directors and three non-executive directors, as detailed on page 9. The independent non-executive directors are Lord Birdwood and Mr Fenn (who is the senior independent non-executive director). The Board is structured so that no one individual or group dominates the decision-making process.

Board meetings are held four times a year and at other times as required to address requirements arising between these scheduled meetings. A formal schedule of matters specifically reserved to the Board, including (inter alia) overall strategy and monitoring of financial performance, has been adopted.

The Board has established an Audit Committee, a Remuneration Committee and a Nominations Committee with duties and responsibilities formally delegated to them.

Audit Committee

I S Fenn (Chairman), Lord Birdwood, R King

The Audit Committee is responsible for ensuring that the financial performance of the Group is properly measured and reported and for reviewing reports from the auditors relating to Group accounts and the Group’s internal control systems.

Remuneration Committee

Lord Birdwood (Chairman), I S Fenn

The Remuneration Committee is responsible for setting the remuneration of the executive directors and the senior management and for the operation of the Company’s share option schemes. The Directors’ Remuneration Report is shown on pages 15 to 17.

Nominations Committee

R King (Chairman), Lord Birdwood, I S Fenn.

The Nominations Committee is responsible for considering and recommending to the Board changes in the Board’s composition and membership.

All non-executive directors of the Company who are members of these committees are entitled to seek, at the Company’s expense, independent professional advice in connection with their roles on these committees.

Internal Control

The Board is ultimately responsible for the Group’s system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss.

Following publication of the guidance for directors on internal control “Internal Control: Guidance for Directors on the Combined Code” (“the Turnbull Guidance”), the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process has been in place throughout the year under review and up to the date of approval of the annual report and accounts and is regularly reviewed by the Board and accords with the guidance.

The Board has reviewed the effectiveness of the system of internal control. In particular it has reviewed and updated the process for identifying and evaluating the significant risks affecting the business and the policies and procedures by which these risks are managed.

REPORT OF THE DIRECTORS CONTINUED

Key elements of the Group's system of internal control are as follows:

Control environment

- the setting of appropriate levels of authorisation which must be adhered to as the Group conducts its business
- the implementation of a recognised organisational and management reporting structure within which individual executive directors have responsibility for the day-to-day running of the business
- established and detailed procedures for the setting of annual budgets and monthly forecasts and the ongoing monitoring of actual financial performance against these targets, on a monthly basis, both at operational and Board level and
- a clearly defined and well-established set of accounting policies which ensure that the financial performance is recorded on a consistent and appropriate basis throughout the Group's reporting entities.

Monitoring and corrective action

There are ongoing procedures in place for monitoring the system of internal financial controls. The remit of the Audit Committee includes meeting to review the effectiveness of the Group's system of internal financial controls, and considering reports made to it by the Group's auditors. The Group does not have an internal audit function. During the year the Board have reviewed the need for an internal audit function and continues to believe that the current size of the Group does not warrant the establishment of an internal audit function. The need for an internal audit function will continue to be reviewed on an annual basis.

Risk management

Management are responsible for the identification and evaluation of significant risks applicable to their areas of the business together with the design and operation of suitable internal controls. These risks are assessed on a continual basis and may be associated with a variety of internal or external sources, including control breakdowns, disruption in information systems, natural catastrophe and regulatory requirements.

Management report to the Board regularly on their review of risks and how they have managed the risks. The Board reviews the key risks inherent in the business and the system of control necessary to manage such risks.

Liquidity risk

The Group finances itself through a combination of equity and short term debt. The Group satisfied its liquidity requirements during the period under review. The Group's main working capital facility is provided by factoring. There was also continued use of short term bank facilities during the period under review. As at 31 August 2003, the Group had committed bank facilities of £2.75 million, of which £1.86 million was undrawn.

Foreign currency risk

The Group faces foreign currency exposures on translation of the net assets and results of its overseas subsidiaries and on trading transactions undertaken mainly in US dollars. The Group seeks to mitigate the effect of its currency exposures by buying currency forward when appropriate. The Group does not hedge its resulting translation exposures as these are accounting rather than cash exposures.

REPORT OF THE DIRECTORS CONTINUED

Relations with shareholders

The Board supports the principle of clear reporting of financial performance to shareholders. Each year shareholders receive a full annual report and an interim report, with supplementary trading statements issued from time to time where appropriate.

Members of the Board will be available at the forthcoming Annual General Meeting to answer any questions from the shareholders.

Compliance statement

Throughout the year the Group has fully complied with the provisions of the Combined Code with the following exceptions:

- Code provision D.3.1 states that the Audit Committee should consist of at least three directors, all of which should be non executive. The Board consider that the inclusion of R King on the Audit Committee is appropriate, given the method of operation of the Group.
- Code provision A.6.2 states that all directors should be subject to re-election at intervals of no more than three years. The executive directors' service contracts were prepared before the Combined Code was issued, and as such do not contain such re-election provisions. An amendment cannot be made unilaterally by the Company to an executive director's service contract and any such amendment would, accordingly, have to be negotiated in turn with each executive director. Given the significant shareholdings of the executive directors, and the potential cost to the Company of compensating the executive directors for any such amendment to their contracts, the Board considers that the existing arrangements with the executive directors should, for the time being, remain undisturbed in this respect.

Going Concern

After making enquiries, the Board considers that the Group has adequate resources to continue operating for the foreseeable future and has therefore adopted the going concern basis in preparing the accounts.

By Order of the Board

K P Shah FCCA
Secretary

Registered Office:
5th Floor, 4 Chiswell Street
London EC1Y 4UP
24 November 2003

Directors' Remuneration Report

The Board presents the Remuneration Report for the year ended 31 August 2003.

The Remuneration Committee

The Remuneration Committee consists of two independent non-executive directors, Lord Birdwood and Mr Fenn. The policy of the Remuneration Committee is framed to give consideration to the provisions as to best practice set out in the Combined Code.

Remuneration of Directors

Each executive director is paid a basic salary and is entitled to benefits, namely payments of pension contributions to a suitable scheme of his choice, the option of the use of a company car, fuel and participation in a private health care scheme.

Each of the executive directors is also entitled under the terms of his service contract to a bonus of an amount up to his basic salary in the event that specified performance targets are met or exceeded. These targets require increases in earnings per share in each financial year of the Group, adjusted to exclude certain exceptional non-trading items.

The basic salaries referred to above are reviewed every year by the Remuneration Committee. The service contracts of the executive directors incorporate notice periods of 12 months.

These arrangements were originally agreed by the Board of Directors in May 1995, just prior to the flotation of the Company on the London Stock Exchange, in consultation with their legal and financial advisers and have recently been reviewed by the Remuneration Committee. In originally establishing these arrangements, and in the recent review, due account was taken of other listed companies of comparable size and business complexity, and in particular of the need to put in place incentive arrangements for each executive director which would be challenging and compatible with sustainable growth in shareholder value, whilst not being over-complicated or manipulable. The Board's policy on pension arrangements is to favour money purchase schemes rather than defined benefit ("final salary") schemes.

The Company believes that share ownership by executive directors and senior executives strengthens the links between their personal interests and those of the shareholders. Executive directors holding less than 10% of the Company's issued share capital are eligible to participate in the Company's Inland Revenue approved executive share option scheme, details of which can be found in note 18 to the accounts. All executive directors are entitled to participate in the Company's unapproved executive share option scheme and in the Company's Enterprise Management Incentive Share Option Scheme, details of which may also be found in note 18 to the accounts.

The non-executive directors are appointed for a fixed term expiring at each Annual General Meeting of the Company, when they may offer themselves for re-election. Lord Birdwood, Mr Fenn and Mr Horvat are each entitled to fees, currently at the rate of £20,000 per annum (2002: £15,000), plus expenses, without any right to compensation on early termination. Mr E Preziosi does not receive any remuneration and Mr Cellai did not receive any remuneration to the date of his resignation.

REPORT OF THE DIRECTORS CONTINUED

The following table shows a breakdown of the remuneration of the directors for the year ended 31 August 2003 and the year ended 31 August 2002. The table has been audited, including the information in respect of the Directors' share options, as referred to in the Independent Auditors' Report.

Year ended 31 August 2003

	Salary/fees	Performance bonus	Benefit in kind	Pension contribution	Total
R King	149,000	149,000	4,902	52,150	355,052
E Preziosi	–	–	–	–	–
K P Shah	144,000	144,000	3,969	36,000	327,969
J J P Kissane	122,000	122,000	2,582	36,600	283,182
J J Diver	122,000	122,000	6,626	24,400	275,026
I S Fenn (non-executive)	17,033	–	–	–	17,033
Lord Birdwood (non-executive)	17,033	–	–	–	17,033
A G Horvat (non-executive)	13,333	–	–	–	13,333
M F V Cellai (non-executive)	–	–	–	–	–
	£584,399	£537,000	£18,079	£149,150	1,288,628

Year ended 31 August 2002

	Salary/fees	Performance bonus	Benefit in kind	Pension contribution	Total
R King	140,833	140,833	17,178	47,250	346,094
E Preziosi	–	–	–	–	–
K P Shah	135,833	135,833	9,990	32,500	314,156
J J P Kissane	115,000	115,000	9,209	27,500	266,709
J J Diver	115,000	115,000	9,209	22,000	261,209
I S Fenn (non-executive)	15,000	–	–	–	15,000
Lord Birdwood (non-executive)	15,000	–	–	–	15,000
M F V Cellai (non-executive)	–	–	–	–	–
	£536,666	£506,666	£45,586	£129,250	£1,218,168

On 28 March 1996, J J P Kissane and J J Diver were each granted options over 100,000 ordinary shares in the Company at an exercise price of 107p per share, exercisable between 28 March 1999 and 27 March 2006. On 4 February 2003, both Messrs Kissane and Diver waived their rights in respect of these options. On 5 February 2003, options over 185,000 new ordinary shares in the Company were granted to each of J J P Kissane and J J Diver. These options have been granted pursuant to the Enterprise Management Incentive Share Option Scheme which was approved by shareholders on 22 January 2003. The options are exercisable at a price of 54 pence per share normally no earlier than three and not later than ten years from the date of grant, subject to the achievement of a predetermined profit related performance target.

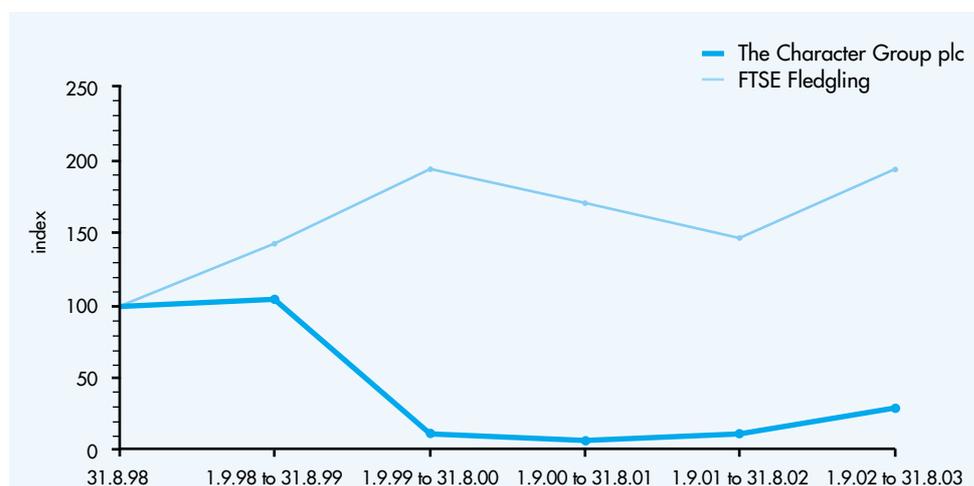
R King, K P Shah, J J P Kissane and J J Diver are the only directors to whom retirement benefits are accruing under a money purchase pension scheme.

At 31 August 2003 the mid-market price of an issued ordinary share in The Character Group plc was 119.5 pence and during the year the price ranged from 24 pence to 123.5 pence.

REPORT OF THE DIRECTORS CONTINUED

The Performance Graph below compares the Total Shareholder Return performance of the Company with the FTSE Fledgling Index over the last five years. The FTSE Fledgling Index has been selected as it includes UK quoted companies of similar size to the Company.

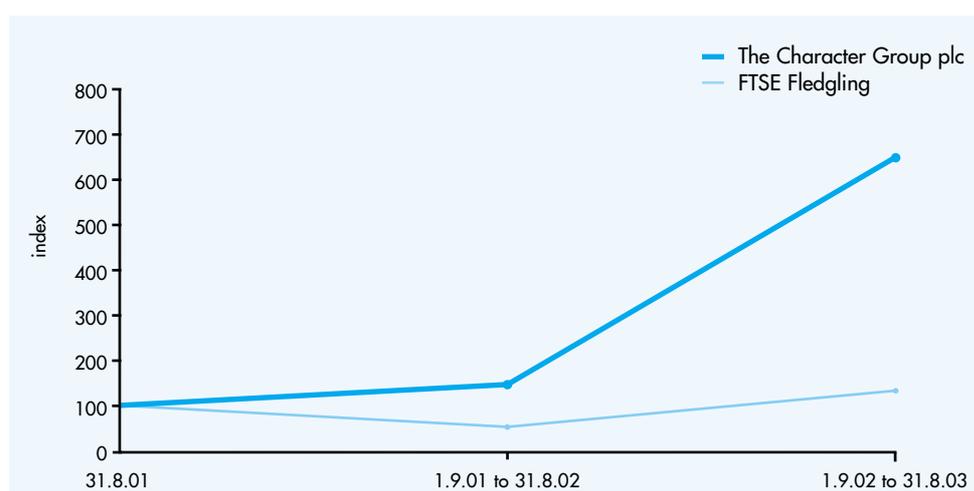
Total Shareholder Return 31 August 1998 to 31 August 2003



In August 2001, the Company completed a rights issue at 20 pence per ordinary share and the issue of a convertible loan note which in total raised £7.84 million net.

The graph below compares the Total Shareholder Return performance of the Company with the FTSE Fledgling Index since 31 August 2001.

Total Shareholder Return 31 August 2001 to 31 August 2003



On behalf of the Board

Lord Birdwood

Chairman, Remuneration Committee

24 November 2003

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE CHARACTER GROUP PLC

We have audited the accounts which comprise the Consolidated Profit and Loss Account, the Consolidated Balance Sheet, the Parent Company Balance Sheet, the Consolidated Cash Flow Statement and the related notes. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration disclosure as set out in the Directors' Remuneration Report and the accounts in accordance with applicable law and United Kingdom Accounting Standards are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the accounts and the part of the Directors' Remuneration Report required to be audited in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the Directors' Remuneration Report that is described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

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

We read the other information contained in the Annual Report and consider whether it is consistent with the audited accounts. This other information comprises only the Report of the Directors, the unaudited part of the Directors' Remuneration Report, the Chairman's Statement and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts and the part of the Directors' Remuneration Report required to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE CHARACTER GROUP PLC CONTINUED

Opinion

In our opinion:

- the accounts give a true and fair view of the state of affairs of the Company and the Group at 31 August 2003 and of the Group profit for the year then ended; and
- the accounts and part of the Directors' Remuneration Report required to be audited have been properly prepared in accordance with the Companies Act 1985

Baker Tilly

Registered Auditor

Chartered Accountants

Marlborough House, Victoria Road South,

Chelmsford, Essex CM1 1LN

24 November 2003

CONSOLIDATED PROFIT AND LOSS ACCOUNT

for the year ended 31 August 2003

	note	2003 £000's	2002 £000's
Turnover	2	85,308	58,939
Cost of sales		(58,610)	(38,933)
Gross profit		26,698	20,006
Net operating expenses			
Selling and distribution costs		(9,138)	(7,119)
Administration expenses		(11,700)	(11,218)
Other operating income		526	408
Operating profit	3	6,386	2,077
Interest	5	(563)	(562)
Profit on ordinary activities before taxation		5,823	1,515
Taxation	6	(287)	(262)
Profit on ordinary activities after taxation		5,536	1,253
Dividend	7	(1,310)	–
Retained profit for the year	19	4,226	1,253
Earnings per share	8		
– basic		13.50p	3.06p
– fully diluted		10.60p	2.52p
– dividend per share	7	3.00p	–
EBITDA (earnings before interest, tax, depreciation and amortisation)		7,395	2,782

All activity has arisen from continuing operations.

There were no material recognised gains or losses other than items dealt with in the profit and loss account above. For exchange rate movements taken to reserves see note 19.

CONSOLIDATED BALANCE SHEET

as at 31 August 2003

	note	2003 £000's	2002 £000's
Fixed assets			
Intangible assets	9	737	773
Tangible assets	10	1,876	1,844
Investments	11	341	74
		2,954	2,691
Current assets			
Stocks	12	8,143	4,982
Trade debtors subject to finance arrangements		7,302	7,946
Factor advances		(5,401)	(6,580)
		1,901	1,366
Debtors – including non-factored trade debtors	13	16,776	10,117
Cash at bank and in hand		3,932	3,284
		30,752	19,749
Creditors: amounts falling due within one year:	14		
Convertible loan note		(4,600)	–
Other creditors		(23,504)	(15,374)
Net current assets		2,648	4,375
Total assets less current liabilities		5,602	7,066
Creditors: amounts falling due after more than one year:	15		
Convertible loan note		–	(4,600)
Other creditors		(4)	(1)
		(4)	(4,601)
Net assets		5,598	2,465
Capital and reserves			
Called up share capital	18	2,064	2,064
Shares to be issued	19, 24	–	908
Capital redemption reserve	19	15	15
Share premium	19	7,843	7,843
Merger reserve	19	651	651
Profit and loss account	19	(4,975)	(9,016)
Equity shareholders' funds	17	5,598	2,465

The accounts on pages 20 to 38 were approved by the Board of Directors on 24 November 2003.

R King
Director

K P Shah
Director

PARENT COMPANY BALANCE SHEET

as at 31 August 2003

	note	2003 £000's	2002 £000's
Fixed assets			
Intangible assets	9	–	773
Tangible assets	10	995	1,049
Investments	11	3,534	1,756
		4,529	3,578
Current assets			
Debtors	13	13,347	14,410
Cash at bank and in hand		296	14
		13,643	14,424
Creditors: amounts falling due within one year:	14		
Convertible loan note		(4,600)	–
Other creditors		(1,969)	(773)
Net current assets		7,074	13,651
Total assets less current liabilities		11,603	17,229
Creditors: amounts falling due after more than one year:	15		
Convertible loan note		–	(4,600)
Net assets		11,603	12,629
Capital and reserves			
Called up share capital	18	2,064	2,064
Shares to be issued	19, 24	–	908
Capital redemption reserve	19	15	15
Share premium	19	7,843	7,843
Profit and loss account	19	1,681	1,799
Equity shareholders' funds	17	11,603	12,629

The accounts on pages 20 to 38 were approved by the Board of Directors on 24 November 2003.

R King
Director

K P Shah
Director

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 August 2003

	note	2003 £000's	2002 £000's
Cash inflow from operating activities	21	3,817	3,064
Returns on investment and servicing of finance			
Interest received		12	17
Interest paid		(574)	(575)
Interest element of finance lease rental payments		(1)	(4)
Net cash outflow for returns on investments and servicing of finance		(563)	(562)
Taxation		(285)	(155)
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets		(1,038)	(770)
Sale of tangible fixed assets		24	200
Purchase of business and assets	9	(902)	–
Net cash outflow for capital expenditure and financial investment		(1,916)	(570)
Equity dividends paid		(410)	–
Cash inflow before financing		643	1,777
Financing			
Capital element of finance lease rentals		5	(37)
Short term bank loan		–	(94)
Net cash inflow/(outflow) from financing		5	(131)
Increase in cash in the year	23	648	1,646
Decrease in net debt in the year	23	643	1,777

NOTES TO THE ACCOUNTS

1 PRINCIPAL ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

The principal accounting policies of the Group are set out below:

Basis of consolidation

The Group accounts for the year ended 31 August 2003 comprise the accounts of the Company and its subsidiaries, all of which are made up to the end of the Company's financial year.

Where part of the purchase consideration for an acquisition is dependent on future profits of the acquired company or business, and can be satisfied, at the Group's option, by the issue of new shares, provision is made for the estimated future consideration and shown in the balance sheet as 'shares to be issued' in accordance with the requirement of FRS 7.

The profit and loss account for the parent Company has not been included, as permitted by Section 230 of the Companies Act 1985. The result of the Company for the financial year dealt with in the consolidated accounts is disclosed in note 19 to the accounts.

Goodwill

Goodwill arising on acquisitions of businesses and subsidiary undertakings is calculated as the excess of the fair value of the consideration given and costs of acquisition over the fair value of the separable net assets acquired. Goodwill arising on acquisitions before 1 September 1998 was written off against reserves immediately on acquisition. In accordance with FRS 10, goodwill arising on acquisitions on or after 1 September 1998 is capitalised as an intangible fixed asset and amortised over its estimated useful economic life. The goodwill carried in the balance sheet is written off over 20 years. Goodwill previously written off directly to reserves has not been reinstated on the balance sheet, but written off against the profit and loss reserve in accordance with the transitional provisions of FRS 10.

On the subsequent disposal or termination of a previously acquired business, the profit or loss on disposal or termination is calculated after charging the amount of any related goodwill taken directly to reserves on acquisition and the net book value of any related goodwill capitalised in the balance sheet.

Investments

Shares in subsidiary undertakings are valued at the lower of cost and recoverable amount, where recoverable amount is the higher of net realisable value and value in use. Provision is made against investments where the diminution in value is considered to be permanent.

Own shares are valued at the lower of cost and market value.

Depreciation

Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost of each asset evenly over its expected useful life. The following principal rates per annum are used:

Freehold buildings	4%
Short leasehold improvements	over the unexpired term of the lease
Tooling	50 – 100%
Fixtures, fittings and equipment	20 – 33%
Motor vehicles	20 – 25%

Stocks

Stocks are stated at the lower of cost and net realisable value. Net realisable value is based on estimated selling price less the estimated cost of disposal.

Factoring arrangements

Certain subsidiaries have factoring agreements under which debts approved by the factor company are assigned to them without recourse. Non-refundable advances are made by the factor company. The directors do not intend that the company will support any losses from factored debts, and the factor company can only seek recourse of funds from the asset financed and can not seek any other recourse. A linked presentation of the relevant balances is therefore shown on the face of the balance sheet in accordance with the requirements of FRS 5. The factor company has a debenture over the assets of the Company and certain subsidiary companies. The factoring charges are charged to the profit and loss account as they accrue. The amount charged to the profit and loss in the year was £302,000 (2002: £438,000). Of this amount £122,000 (2002: £207,000) has been charged as interest (see note 5), with the remainder being charges made by the factor company which have been included within administration expenses.

NOTES TO THE ACCOUNTS CONTINUED

1 PRINCIPAL ACCOUNTING POLICIES CONTINUED

Foreign currencies

In the accounts of individual group undertakings, transactions in foreign currencies are recorded in the local currency using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains and losses on translation are included in the profit and loss account. In the consolidated accounts, the results and the balance sheets of overseas subsidiary undertakings are translated at the year end exchange rates. Exchange differences resulting from the re-translation of opening net assets are dealt with in reserves. All other exchange differences are dealt with in the profit and loss account.

Leasing and hire purchase contracts

Assets held under finance leases and hire purchase contracts are capitalised in the balance sheet and are depreciated over their useful lives. The interest element of the rental obligations is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. Rentals paid under operating leases are charged to income as incurred.

Financial instruments

Financial assets are recognised on the balance sheet at the lower of cost and net realisable value. Discounts and premia are charged or credited to the profit and loss account over the life of the asset or liability to which they relate. The Group has taken advantage of the exemption available for short term debtors and creditors.

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Pension contributions

The Group operates defined contribution pension schemes. Contributions are allocated to the profit and loss account when due.

Research and development

Research and development costs represent expenditure that is directly attributable to the development of products, and are written off as an expense in the year incurred.

2 TURNOVER

Turnover represents the amount derived from the provision of goods and services which arise from the Group's ordinary activities, stated net of value added tax.

Analysis of turnover by geographical market by destination	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
United Kingdom	51,781	42,213
Rest of the world	33,527	16,726
Total	85,308	58,939

Analysis of turnover by division	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
Toys and games	43,988	36,097
Giftware	7,387	8,498
Digital	33,933	14,344
Total	85,308	58,939

All the Group's activities during the 12 months ended 31 August 2003 are classed as continuing. The directors consider that the disclosure of further disaggregated information would be seriously prejudicial to the commercial interests of the Group.

NOTES TO THE ACCOUNTS CONTINUED

3 OPERATING PROFIT

	note	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
Operating profit is stated after charging:			
Staff costs	4	6,686	5,846
Auditors' remuneration – audit services		107	98
– non audit services		33	35
Operating leases – land and buildings		291	240
Research and development costs		1,023	370
Depreciation of tangible fixed assets			
– owned assets		975	658
– assets held under finance leases and HP contracts		4	2
		979	660
Goodwill amortisation		30	45

4 DIRECTORS AND EMPLOYEES

		12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
Staff costs including directors' emoluments			
Wages and salaries		5,856	5,196
Social security costs		522	402
Other pension costs		308	248
		6,686	5,846
The average number of employees during the year was:		Number	Number
Management and administration		73	72
Selling and distribution		130	100
		203	172

The amount payable to pension schemes as at the balance sheet date was £88,000 (2002: £64,000).

Details of directors' remuneration and share options are given in the Directors' Remuneration Report on pages 15 to 17. This information forms part of these accounts.

5 INTEREST

	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
Total interest receivable	12	17
Total interest payable:		
On bank overdraft and similar charges	(222)	(138)
Convertible loan note interest	(230)	(230)
Finance leases and hire purchase contracts	(1)	(4)
Factor advances	(122)	(207)
	(563)	(562)

NOTES TO THE ACCOUNTS CONTINUED

6 TAXATION

	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
UK Corporation Tax		
Tax on profit for the period	–	–
Foreign Tax		
Tax on profit for the period	552	224
Total current tax	552	224
Deferred Tax		
Tax losses	(473)	–
Origination and reversal of timing differences	208	38
Total deferred tax	(265)	38
Tax on profit on ordinary activities	287	262
Factors affecting tax charge for the period		
Profit on ordinary activities before taxation	5,823	1,515
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2002: 30%)	1,747	455
Effects of:		
Expenses not deductible for tax purposes	164	160
Capital allowances in excess of depreciation	(212)	(194)
Other temporary differences between taxable and accounting profit	(481)	38
Lower tax rate on overseas earnings	(413)	(235)
Utilisation of tax losses	(445)	–
Tax losses not utilised	192	–
Current tax charge for the year	552	224

The deferred tax credit for the year includes a value for tax losses previously unrecognised. These losses were previously unrecognised as the Directors did not consider that there was sufficient evidence to support the recognition of a deferred tax asset. Having considered the results of the subsidiary companies for the year ended 31 August 2003, and prepared forecasts for the period ahead, the Directors are of the opinion that some of the tax losses within the Group will be recovered against future taxable profits within a time horizon which they consider to be reasonable.

7 DIVIDEND

	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
On equity shares:		
Interim dividend paid – 1p (2002: 0p) per share	410	–
Final dividend proposed – 2p (2002: 0p) per share	900	–
Total	1,310	–

NOTES TO THE ACCOUNTS CONTINUED

8 EARNINGS PER SHARE

	12 months to 31 August 2003			12 months to 31 August 2002		
	Profit after taxation	Weighted average number of ordinary shares	Pence per share	Profit after taxation	Weighted average number of ordinary shares	Pence per share
Basic earnings per share	5,536,000	41,002,909	13.50	1,253,000	41,002,909	3.06
Impact of shares to be issued	–	–	–	–	3,632,000	(0.25)
Impact of share option schemes	–	1,224,118	(0.39)	–	–	–
Impact of convertible loan note	161,000	11,500,000	(2.51)	161,000	11,500,000	(0.29)
Diluted earnings per share	5,697,000	53,727,027	10.60	1,414,000	56,134,909	2.52

9 INTANGIBLE ASSETS - GOODWILL

The Group

Cost	£000's
1 September 2002	908
Decrease in deferred consideration from previous year	(6)
31 August 2003	902
Amortisation	
1 September 2002	135
Charge for the year	30
31 August 2003	165
Net book value	
31 August 2003	737
31 August 2002	773

During the year ended 31 August 2000 the Group acquired the business and assets of The Really Useful Games Company Limited. Character Games Limited, a wholly owned subsidiary of The Character Group plc, was formed to carry on the business acquired from The Really Useful Games Company Limited.

The final cost of the acquisition was based on sales and post-tax profits of Character Games Limited for the three years ended 31 December 2002. The consideration could be satisfied in whole or in part at the Company's option by the issue of new shares in The Character Group plc at market value.

The value of the consideration for the acquisition was finalised during the year ended 31 August 2003 and the consideration was settled in cash by Character Games Limited, rather than by the issue of shares in The Character Group plc. The acquisition of the business and assets of The Really Useful Games Company Limited was originally accounted for in the Company but has now been accounted for in the accounts of Character Games Limited following payment of the consideration.

The Company

Cost	£000's
1 September 2002	908
Adjustment on settlement by a subsidiary company	(908)
31 August 2003	–
Amortisation	
1 September 2002	135
Adjustment on settlement by a subsidiary company	(135)
31 August 2003	–
Net book value	
31 August 2003	–
31 August 2002	773

NOTES TO THE ACCOUNTS CONTINUED

10 TANGIBLE FIXED ASSETS

The Group

Cost	Freehold land and buildings £000's	Short leasehold improvements £000's	Tooling £000's	Fixtures fittings and equipment £000's	Motor vehicles £000's	Total £000's
1 September 2002	1,182	85	496	1,612	506	3,881
Additions	–	13	706	224	95	1,038
Disposals	–	–	–	(15)	(206)	(221)
Differences on exchange	–	(1)	(12)	(8)	–	(21)
31 August 2003	1,182	97	1,190	1,813	395	4,677
Depreciation						
1 September 2002	200	35	227	1,303	272	2,037
Charge for the year	48	25	633	178	95	979
Disposals	–	–	–	(14)	(186)	(200)
Exchange rate movement	–	(1)	(7)	(7)	–	(15)
31 August 2003	248	59	853	1,460	181	2,801
Net book value						
31 August 2003	934	38	337	353	214	1,876
31 August 2002	982	50	269	309	234	1,844

The net book value of fixed assets includes £2,000 (2002: £6,000) in respect of assets held under finance leases and hire purchase contracts, the depreciation of which is shown in note 3.

The Company

Cost	Freehold land and buildings £000's	Fixtures fittings and equipment £000's	Motor vehicles £000's	Total £000's
1 September 2002	1,182	104	54	1,340
Additions	–	26	–	26
Disposals	–	–	(28)	(28)
31 August 2003	1,182	130	26	1,338
Depreciation				
1 September 2002	200	53	38	291
Charge for the year	48	21	5	74
Disposals	–	–	(22)	(22)
31 August 2003	248	74	21	343
Net book value				
31 August 2003	934	56	5	995
31 August 2002	982	51	16	1,049

NOTES TO THE ACCOUNTS CONTINUED

11 FIXED ASSET INVESTMENTS

The Group

Cost	Own shares £000's	Shares listed in the UK £000's	Total £000's
1 September 2002 and 31 August 2003	908	2	910
Amortisation and provisions			
1 September 2002	(836)	–	(836)
Movement in provision	267	–	267
31 August 2003	(569)	–	(569)
Net book value			
31 August 2003	339	2	341
31 August 2002	72	2	74

The market value of the listed investments is £2,206 (2002: £1,897).

The Company

Cost	Shares in subsidiary undertakings £000's	Joint venture £000's	Own shares £000's	Total £000's
1 September 2002 and 31 August 2003	3,537	1	908	4,446
Amortisation and provisions				
1 September 2002	(1,853)	(1)	(836)	(2,690)
Movement in provision	1,511	–	267	1,778
31 August 2003	(342)	(1)	(569)	(912)
Net book value				
31 August 2003	3,195	–	339	3,534
31 August 2002	1,684	–	72	1,756

Issued shares in the Company are held by the trustee of the Company's Employee Share Ownership Trust ("the Trust") for the benefit of the Group's employees, former employees and their respective families. At 31 August 2003 the Trust held 285,000 shares (2002: 285,000) which had a market value of £339,000 (2002: £72,000). In accordance with UITF 13 these shares have been stated at the lower of cost and market value. The nominal value of the shares held by the Trust is £14,250.

The Company

At 31 August 2003 the Company held more than 10% of the equity of the following principal undertakings:

Subsidiaries	Country of incorporation and operation	Class of share capital held	Proportion held by the parent undertaking	Nature of business
Character Options Limited	United Kingdom	Ordinary	100%	Design and distribution of toys and games
Toy Options (Far East) Limited	Hong Kong	Ordinary	100%	Design and distribution of toys and games
Character Games Limited	United Kingdom	Ordinary	100%	Design and distribution of games and puzzles
Character Games (Far East) Limited	Hong Kong	Ordinary	100%	Design and distribution of games and puzzles
Downpace Limited	United Kingdom	Ordinary	100%	Gift importer and distributor
World Wide Licenses Limited	Hong Kong	Ordinary	100%	Design and distribution of digital cameras
WWL (Europe) Limited	United Kingdom	Ordinary	100%	Distribution of digital cameras

All of the subsidiary undertakings have been included in these consolidated accounts.

NOTES TO THE ACCOUNTS CONTINUED

12 STOCKS

	The Group 2003 £000's	The Group 2002 £000's
Raw materials	1,237	557
Finished goods for resale	6,906	4,425
	8,143	4,982

13 DEBTORS

	The Group 2003 £000's	The Group 2002 £000's	The Company 2003 £000's	The Company 2002 £000's
Due from subsidiary undertakings	–	–	12,770	13,650
Trade debtors (non-factored)	13,695	6,479	–	–
Other debtors	876	1,366	304	154
Prepayments and accrued income	1,456	1,788	166	568
Other taxation and social security	–	–	107	38
Deferred tax	749	484	–	–
	16,776	10,117	13,347	14,410

Deferred Tax

The elements of deferred tax are as follows:

	2003 £000's	2002 £000's
Difference between accumulated depreciation and tax depreciation	197	104
Other timing differences	(272)	29
Tax losses	824	351
	749	484

The movements in deferred tax are as follows:

	2003 £000's	2002 £000's
At 1 September 2002	484	522
Profit and loss account	265	(38)
At 31 August 2003	749	484

The deferred tax asset of £749,000 (2002: £484,000) is recoverable against future forecast taxable profits within a time horizon that the directors consider more likely than not to occur.

Deferred tax assets have not been recognised in respect of tax losses of £5,271,000 (2002: £12,793,000). At a tax rate of 30%, these losses represent a potential tax asset of £1,581,000 (2002: £3,838,000). These losses would be recoverable in the event of taxable profits arising in certain subsidiary companies.

NOTES TO THE ACCOUNTS CONTINUED

14 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	The Group 2003 £000's	The Group 2002 £000's	The Company 2003 £000's	The Company 2002 £000's
Trade creditors	17,313	7,390	–	–
Due to subsidiary undertakings	–	–	86	75
Corporation tax	712	175	–	–
Other taxation and social security	803	713	137	–
Accruals and deferred income	4,671	7,093	1,746	698
Finance leases and hire purchase contracts	5	3	–	–
Convertible loan note	4,600	–	4,600	–
	28,104	15,374	6,569	773

A bank has a debenture over the assets and undertakings of the Company and certain subsidiary companies. Further, a major trade creditor who offers trade finance is secured by a debenture over the assets and undertakings of a subsidiary company. As at 31 August 2003 the amount outstanding to the secured trade creditor amounted to £1,487,000 (2002: £1,225,000).

Convertible loan note

On 16 July 2001 the Company issued a convertible loan note.

The earliest redemption date is 16 July 2004. The outstanding, unconverted amount of the loan note is repayable at its nominal value at the option of the Company or the noteholder at any time on or after this date, subject to a notice period of 30 days.

The note is convertible, in whole or in part, into up to 11,500,000 ordinary shares of 5p each at a rate of 40p (nominal) per share at any time prior to 16 July 2004, at the option of the noteholder.

The note will become repayable forthwith in the event of a default, which means any of the following:

- (i) the Company is 14 days late with any payment
- (ii) the Company fails to comply with any term of the loan note agreement, after 30 days notice thereof is given to the Company
- (iii) the Company is wound up or a receiver or administrator is appointed.

Details of a partial conversion of the convertible loan note are set out in note 29.

15 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	The Group 2003 £000's	The Group 2002 £000's	The Company 2003 £000's	The Company 2002 £000's
Convertible loan note (see note 14)	–	4,600	–	4,600

	The Group 2003 £000's	The Group 2002 £000's
Other creditors		
Finance leases and hire purchase contracts repayable in less than five years	4	1

16 PROVISION FOR LIABILITIES AND CHARGES

Investment in joint venture

The movement in the share of gross assets less the share of gross liabilities in the investment in the joint venture was as follows:

	The Group 2003 £000's	The Group 2002 £000's
1 September 2002	–	13
Movement in provision	–	(13)
31 August 2003	–	–

NOTES TO THE ACCOUNTS CONTINUED

17 RECONCILIATION OF EQUITY SHAREHOLDERS' FUNDS

	The Group 12 months to 31 August 2003 £000's	The Group 12 months to 31 August 2002 £000's	The Company 12 months to 31 August 2003 £000's	The Company 12 months to 31 August 2002 £000's
Profit/(loss) for the financial period	4,226	1,253	(118)	89
Exchange differences taken to reserves	(185)	(464)	–	–
Movement in shares to be issued	(908)	–	(908)	–
Net addition to/(subtraction from) shareholders' funds	3,133	789	(1,026)	89
Opening shareholders' funds	2,465	1,676	12,629	12,540
Closing shareholders' funds	5,598	2,465	11,603	12,629

18 CALLED UP SHARE CAPITAL (EQUITY)

	2003 £000's	2002 £000's
Authorised		
110,000,000 (2002: 110,000,000) ordinary shares of 5 pence each	5,500	5,500
Allotted called up and fully paid		
41,287,909 (2002: 41,287,909) ordinary shares of 5 pence each	2,064	2,064

Share options

The Company adopted the rules of an Inland Revenue approved executive share option scheme on 3 May 1995. At 1 September 2002, options to acquire up to a total of 798,500 new ordinary shares remained outstanding under this scheme. As at 31 August 2003, options to acquire up to a total of 522,000 new ordinary shares in the Company remained outstanding under this scheme details of which were as follows:

No. of shares	Date granted	Exercise period	Exercise price
24,000	5 March 1997	5 March 2000 to 4 March 2007	101.0p
18,000	5 December 1997	5 December 2000 to 4 December 2007	136.5p
480,000	15 February 2002	15 February 2005 to 14 February 2012	24.25p

The Company adopted the rules of its unapproved executive share option scheme on 2 June 1997. At 1 September 2002 options to acquire up to a total of 382,500 new ordinary shares remained outstanding under this scheme. On 5 February 2003 options over a total of 352,500 new ordinary shares in the Company were granted to Group employees at an exercise price of 54.0p per share. As at 31 August 2003, options to acquire up to a total of 688,000 new ordinary shares in the Company remained outstanding under this scheme, details of which were as follows:

No. of shares	Date granted	Exercise period	Exercise price
128,500	5 December 1997	5 December 2000 to 4 December 2004	136.5p
207,000	15 February 2002	15 February 2005 to 14 February 2009	24.25p
352,500	6 February 2003	6 February 2006 to 5 February 2010	54.0p

The Company adopted the rules of an Inland Revenue qualifying Enterprise Management Incentive share option scheme with the sanction of shareholders following an extraordinary general meeting of the Company on 22 January 2003. On 5 February 2003, options over a total of 1,131,250 new ordinary shares in the Company were granted to Group employees at an exercise price of 54p per share. As at 31 August 2003, options to acquire a total of 1,131,250 new ordinary shares in the Company remained outstanding under this scheme. These options are exercisable during the period from 5 February 2006 until 4 February 2013.

No amount is payable by any grantee of an option at the time of grant under any of the Company's executive share option schemes.

NOTES TO THE ACCOUNTS CONTINUED

19 SHARE CAPITAL AND RESERVES

	Called up share capital £000's	Shares to be issued £000's	Capital redemption reserve £000's	Share premium account £000's	Merger reserve £000's	Profit and loss account £000's	Total £000's
The Group							
1 September 2002	2,064	908	15	7,843	651	(9,016)	2,465
Exchange differences	–	–	–	–	–	(185)	(185)
Profit retained	–	–	–	–	–	4,226	4,226
Movement	–	(908)	–	–	–	–	(908)
31 August 2003	2,064	–	15	7,843	651	(4,975)	5,598
The Company							
1 September 2002	2,064	908	15	7,843	–	1,799	12,629
Loss retained	–	–	–	–	–	(118)	(118)
Movement	–	(908)	–	–	–	–	(908)
31 August 2003	2,064	–	15	7,843	–	1,681	11,603

In accordance with FRS 10, goodwill previously written off against reserves has not been reinstated and the goodwill has been offset against the profit and loss account reserve. The cumulative amount of positive goodwill written off against reserves is £5,645,000 (31 August 2002: £5,645,000). The goodwill has been eliminated as a matter of accounting policy and would be charged to the profit and loss account on the subsequent disposal of the business to which it related.

20 GUARANTEES AND OTHER FINANCIAL COMMITMENTS

a. Financial commitments under non-cancellable operating leases will result in the following payments falling due in the year to 31 August 2004

	2003 Land and buildings £000's	2002 Land and buildings £000's
Expiring within one year	241	217
Expiring between one and five years	225	271
Expiring after five years or more	–	245
	466	733

b. The Group has entered into contracts for minimum royalties in the amounts set out below which are contracted to be paid to licensors irrespective of sales and are not provided for in the accounts as the directors believe that the required level of future sales will be achieved:

	2003 £000's	2002 £000's
Within one year	1,843	928
Between one and two years*	1,632	1,008
Between two and five years	–	968
	3,475	2,904

* A subsidiary has an option to terminate one of these contracts in which event a substantial part of these amounts would not be payable.

c. The future minimum hire purchase and finance lease payments to which the Group was committed at 31 August 2003 are:

	2003 £000's	2002 £000's
Net amounts payable within one year	5	3
Net amount payable between two and five years	4	1
	9	4

NOTES TO THE ACCOUNTS CONTINUED

21 RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
Operating profit	6,386	2,077
Depreciation, impairment and amortisation	1,009	705
Movement in respect of own shares	(267)	(21)
(Profit)/loss on disposal of fixed assets	(3)	78
(Increase)/decrease in stocks	(3,161)	2,803
Increase in debtors	(6,659)	(3,632)
Increase in creditors	6,697	1,518
Exchange movement	(185)	(464)
Net cash inflow from operating activities	3,817	3,064

22 RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	12 months to 31 August 2003 £000's	12 months to 31 August 2002 £000's
Increase in cash in the period	648	1,646
Cash (outflow)/inflow from movement in debt and lease financing	(5)	131
Movement in net debt resulting from cash flows	643	1,777
Net debt at 1 September 2002	3,280	1,503
Net debt at 31 August 2003	3,923	3,280

23 ANALYSIS OF NET DEBT

	Cash at bank and in hand £000's	Short-term bank loan £000's	Lease finance £000's	Total £000's
1 September 2001	1,638	(94)	(41)	1,503
Cash flow	1,646	94	37	1,777
31 August 2002	3,284	–	(4)	3,280
Cash flow	648	–	(5)	643
31 August 2003	3,932	–	(9)	3,923

24 SHARES TO BE ISSUED

	note	£000's
1 September 2002		908
Movement	9	(908)
31 August 2003		–

The final part of the consideration in respect of the acquisition of the business and assets of The Really Useful Games Company Limited was agreed on 10 July 2003 to be paid in cash. Further details of this transaction are set out in note 9.

NOTES TO THE ACCOUNTS CONTINUED

25 FINANCIAL INSTRUMENTS

The Group's use of financial instruments is explained under the heading of 'Risk Management' in Corporate Governance starting on page 12. As permitted by FRS 13 short term debtors and creditors have been excluded from all financial instrument disclosures.

a. Exchange risk

The tables below show the Group's currency exposures; in other words those transactional exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating currency of the operating company involved.

These currency exposures were as follows:

Net foreign currency monetary assets	At 31 August 2003			At 31 August 2002		
	Functional currency of group operation			Functional currency of group operation		
	Sterling £000's	HK\$ £000's	Total £000's	Sterling £000's	HK\$ £000's	Total £000's
Sterling	–	7	7	–	1	1
US\$	(117)	988	871	(76)	877	801
Euro	15	–	15	97	1	98
Total	(102)	995	893	21	879	900

b. Fair values

The fair value of all financial instruments at 31 August 2003 and 31 August 2002 was not materially different from their book value

c. Maturity of financial liabilities

The maturity profile of the Group's financial liabilities at 31 August 2003 was as follows:

	2003 £000's	2002 £000's
In one year or less, or on demand	4,600	3
In more than one year, but not more than two years	4	4,601
In more than two years, but not more than five years	–	–
In more than five years	–	–
Total	4,604	4,604

d. Borrowing facilities

The Group has various available borrowing facilities. The undrawn committed facilities available in respect of which all conditions had been met at 31 August 2003, were as follows:

	2003 £000's	2002 £000's
Expiring within one year	1,860	2,156
Expiring between one year, but not more than two years	–	–
Expiring in more than two years	–	–
Total	1,860	2,156

NOTES TO THE ACCOUNTS CONTINUED

25 FINANCIAL INSTRUMENTS CONTINUED

e. Interest rate risk profile of financial assets and financial liabilities

Financial assets

Financial assets comprise cash at bank.

Currency	At 31 August 2003				At 31 August 2002			
	Floating rate financial assets £000's	Fixed rate financial assets £000's	Financial assets on which no interest received £000's	Total £000's	Floating rate financial assets £000's	Fixed rate financial assets £000's	Financial assets on which no interest received £000's	Total £000's
Sterling	2,043	–	–	2,043	2,337	–	–	2,337
US\$	871	–	–	871	801	–	–	801
Euro	15	–	–	15	98	–	–	98
HK\$	1,003	–	–	1,003	48	–	–	48
Total	3,932	–	–	3,932	3,284	–	–	3,284

Financial liabilities

Currency	At 31 August 2003				At 31 August 2002			
	Floating rate financial liabilities £000's	Fixed rate financial liabilities £000's	Financial liabilities on which no interest is paid £000's	Total £000's	Floating rate financial liabilities £000's	Fixed rate financial liabilities £000's	Financial liabilities on which no interest is paid £000's	Total £000's
Sterling	–	4,600	–	4,600	4	4,600	–	4,604
US\$	–	–	–	–	–	–	–	–
HK\$	–	4	–	4	–	–	–	–
Total	–	4,604	–	4,604	4	4,600	–	4,604

The floating rate financial liabilities comprise:

- Sterling denominated bank borrowings and overdrafts that bear interest at rates based on LIBOR or NatWest bank base rates.
- Obligations under finance leases and hire purchase contracts.

The fixed rate financial liability comprises the convertible loan note. Interest is payable at the rate of 5% per annum. Further details regarding the convertible loan note are set out in note 14.

26 THE CHARACTER GROUP PLC EMPLOYEE SHARE OWNERSHIP TRUST

The Company's Employee Share Ownership Trust ("the Trust") is governed by a Trust Deed dated 19 June 1998. The Trustees may grant options over such shares in the Company acquired by them or otherwise provide benefits to the beneficiaries, as defined in the Trust Deed. The Trust is required to meet its own costs, and has waived its right to dividend income. At 31 August 2003, no options had been granted by the Trust. Details of the shares held by the Trust are set out in note 11.

27 CONTINGENT LIABILITIES

The Company has guaranteed the obligations of certain subsidiary companies to their factor companies, trade finance companies, certain banks and others in the normal course of business. The factor company has a fixed and floating charge over the assets of the Company and some subsidiaries. The Company is a member of a Group registration for Value Added Tax purposes.

28 RELATED PARTY TRANSACTIONS

During the year the Company entered into transactions with Giochi Preziosi S.p.A., a company of which E Preziosi and M Cellai are directors. Giochi Preziosi S.p.A. held approximately 28.8% of the issued share capital of The Character Group plc at 31 August 2003.

Trade was carried out on an arms length basis and is summarised below:

	2003 £000's	2002 £000's
Total net sales to Giochi Preziosi S.p.A.	1,374	479
Total net purchases from Giochi Preziosi S.p.A.	2,862	2,148
Balance due from/(due to) Giochi Preziosi S.p.A.	175	(90)

29 POST BALANCE SHEET EVENT

On 11 November 2003, Valtidone S.p.A., the holder of the £4,600,000 (nominal) convertible loan note in The Character Group plc, converted £1,600,000 (nominal) of the loan note into new ordinary shares, at a conversion price of 40 pence per ordinary share. This resulted in the allotment of 4,000,000 ordinary shares with a nominal value of £200,000, representing approximately 8.8% of the Company's issued share capital as enlarged by the issue of the new ordinary shares. The new ordinary shares were allotted on 11 November 2003 and admitted to the Official List on 17 November 2003. If the unconverted amount of the loan note, £3,000,000 (nominal), was to be fully converted, it would result in the issue of a further 7,500,000 new ordinary shares of 5 pence each. The Company received a notification from Valtidone S.p.A. on 24 November 2003 of its sale of the 4,000,000 new ordinary shares. Valtidone S.p.A. no longer holds any interest in issued shares in the capital of the Company.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN THAT the ninth Annual General Meeting of The Character Group plc will be held at the offices of Citigate Dewe Rogerson, 26 Finsbury Square, London EC2A 1DS on 21 January 2004 at 11.00 am to transact the following business:

Ordinary business

- 1 To approve the Directors' Remuneration Report for the year ended 31 August 2003.
- 2 To receive and adopt the directors' report and the accounts of the Company for the year ended 31 August 2003 and the report of the auditors thereon.
- 3 To re-elect Lord Birdwood, who retires in accordance with the terms of his appointment, as a director of the Company.
- 4 To re-elect Mr I S Fenn, who retires in accordance with the terms of his appointment, as a director of the Company.
- 5 To re-elect Mr A G Horvat, who retires in accordance with the terms of his appointment, as a director of the Company.
- 6 To re-appoint Baker Tilly as auditors for the ensuing year and to authorise the directors to fix their remuneration.

Special business

To consider and, if thought fit, pass the following resolutions which in the cases of resolutions numbered 7,8 and 9 will be proposed as ordinary resolutions of the Company and in the case of resolution numbered 10 shall be proposed as a special resolution of the Company:

- 7 That for the purposes of Section 80 of the Companies Act 1985 the directors be and are hereby generally and unconditionally authorised to exercise all powers of the company to allot relevant securities (as defined in that section) up to an aggregate nominal amount of £688,132 such authority to expire on the earlier of fifteen months following the date upon which this resolution was passed and the conclusion of the Annual General Meeting of the Company next following the date upon which this resolution was passed unless renewed, varied or revoked by the company in general meeting provided that the company may at any time before the expiry, variation or revocation of such authority make offers or agreements which will or might require relevant securities to be allotted after the expiry, variation or revocation of such authority and the directors may allot relevant securities pursuant to such offer or agreement as if such authority had not expired or been varied or revoked. This authority shall replace all existing authorities conferred on the directors in respect of the allotment of relevant securities to the extent that the same have not previously been utilised.
- 8 That the directors be and are hereby authorised for the purposes of Article 147 of the Articles of Association of the Company, to offer to members of the Company, in accordance with the provisions of the said Article, the right to elect to receive ordinary shares, credited as fully paid, in whole or in part instead of cash in respect of all or any dividends declared or paid by the the Company or the directors pursuant to the Articles of Association of the Company at any time after the date of the passing of this resolution was passed and the conclusion of the Annual General Meeting of the Company next following the date upon which this resolution was passed and that the directors be and are hereby authorised to make any such offer on such terms and conditions to such members of the Company, subject always to the provisions of the Articles of Association of the Company, as they shall in their absolute discretion determine.
- 9 That the Company is hereby generally and unconditionally authorised to make market purchases (as defined in section 163(3) of the Companies Act 1985) of ordinary shares of 5p each in the capital of the Company provided that:
 - (A) the maximum number of ordinary shares 5p each in the capital of the Company hereby authorised to be acquired 6,790,000;
 - (B) the minimum price (exclusive of all expenses) which may be paid for such shares is 5p per share;
 - (C) the maximum price which may be paid for such shares is, in respect of a share contracted to be purchased on any day, an amount equal to 105 per cent of the average of the middle-market prices shown in the quotations for ordinary shares of the Company in the Daily Official List of the London Stock Exchange on the five business days immediately preceding the day on which the share is contracted to be purchased;

NOTICE OF ANNUAL GENERAL MEETING CONTINUED

- (D) the authority hereby conferred shall expire at the earlier of the conclusion of the next Annual General Meeting following the date upon which this resolution was passed, or 15 months following the date upon which this resolution was passed; and
- (E) the Company may contract to purchase its own shares under the authority hereby conferred prior to the expiry of such authority, which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of its own shares in pursuant of any such contract.

10 That:

- (A) the directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 (“the Act”) to allot equity securities (as defined in Section 94 of the Act) pursuant to the authority conferred on them for the purposes of Section 80 of the Act by an ordinary resolution of the company of even date herewith as if Section 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited:
 - (i) to the allotment of equity securities in connection with any offer by way of rights to holders of ordinary shares in the capital of the company notwithstanding that, by reason of such exclusions or other arrangements as the directors may deem necessary or desirable to deal with legal or other problems arising in any overseas territory, in connection with fractional entitlements, record dates or otherwise howsoever, the equity securities to be allotted are not offered to all such holders in proportion to the respective number of ordinary shares held by them;
 - (ii) to the allotment of equity securities pursuant to Article 147 of the Articles of Association of the Company in favour of holders of ordinary shares in the capital of the Company where the equity securities respectively attributable to the interests of such holders on a fixed record date are proportionate (as nearly as may be) to the respective number of ordinary shares held by them but subject to such exclusions or other arrangements as the directors may deem necessary or desirable to deal with legal or practical problems under the laws, or the requirements, of any regulatory authority in any territory or otherwise howsoever in relation to fractional entitlements.
 - (iii) to the allotment (otherwise than pursuant to paragraphs (i) and (ii) above) of equity securities up to an aggregate nominal value of £103,220 (being approximately 5% of the nominal value of the issued ordinary share capital of the Company as at 31 August 2003);
- (B) the power hereby conferred shall expire at the earlier of the conclusion of the next Annual General Meeting following the date on which this resolution was passed or fifteen months following the date upon which this resolution was passed;
- (C) the power hereby conferred shall enable the Company to make an offer or agreement that would or might require equity securities to be allotted after such power expires and the directors may allot equity securities in pursuance of any such offer or agreement made within the limits prescribed in paragraph (A) above as if the power hereby conferred had not expired; and
- (D) this power shall replace all existing powers granted to the directors to allot equity securities as if the said Section 89(1) of the Act did not apply to the extent that the same have not been previously utilised.

Other business

11 To transact any other business which may lawfully be transacted at the Annual General Meeting.

By order of the Board

K P Shah FCCA, Secretary
27 November 2003

Registered Office

5th Floor
4 Chiswell Street
London EC1Y 4UP

NOTICE OF ANNUAL GENERAL MEETING CONTINUED

Notes:

1. The register of directors' interests and copies of the directors' service agreements will be available for inspection at the registered office during normal business hours from the date of this notice until the date of the Annual General Meeting and on that day will be available for inspection at the place of the meeting from 10 am until the conclusion of the meeting.
2. A member entitled to attend and vote at the Annual General Meeting convened by the Notice above is entitled to appoint a proxy to attend and, on a poll, vote in his place. A proxy need not be a member of the company.
3. To be valid, forms of proxy must be lodged with Neville Registrars Limited, 18 Laurel Lane, Halesowen, West Midlands, B63 3DA not less than 48 hours before the time appointed for holding the Annual General Meeting. A form of proxy is set out on page 43.
4. Completion of a form of proxy does not prevent a member from attending and voting at the Annual General Meeting should he or she so wish.
5. In order to have the right to attend and vote at the Annual General Meeting, a person must be entered on the register of members at 5.00 pm on 19 January 2004 or, in the case of an adjournment of the Annual General Meeting, at the time which is 48 hours before the time appointed for the adjourned meeting.

We would appreciate it if the Form of Proxy was completed in full.

If you would like to receive information about The Character Group plc sent to you by email, please register your details at www.charactergroup.plc.uk

FORM OF PROXY

THE CHARACTER GROUP PLC

For use at the Annual General Meeting of the Company on 21 January 2004

I/We _____
(please use block capitals)

of _____ (being (a)
holders(s) of ordinary shares in the above named company) hereby appoint the Chairman of the meeting

_____ (note 1)

as my/our proxy to vote on my/our behalf at the Annual General Meeting to be held at the offices of Citigate Dewe
Rogerson, 26 Finsbury Square, London EC2A 1DS on 21 January 2004 at 11 am and any adjournment thereof.

Please indicate with a ✓ in the spaces below in either the for or against column how you wish your vote to be cast.

	FOR	AGAINST
1. Ordinary resolution – approval of the Directors' Remuneration Report		
2. Ordinary resolution – adoption of accounts for year ended 31 August 2003		
3. Ordinary resolution – re-election of Lord Birdwood as a director		
4. Ordinary resolution – re-election of Mr I S Fenn as a director		
5. Ordinary resolution – re-election Mr A G Horvat as a director		
6. Ordinary resolution – re-appointment of Baker Tilly as auditors		
7. Ordinary resolution – authority to allot shares		
8. Ordinary resolution – authority to allot shares in lieu of cash dividends		
9. Ordinary resolution – authority to purchase own shares in the market		
10. Special resolution – disapplication of pre-emption rights		

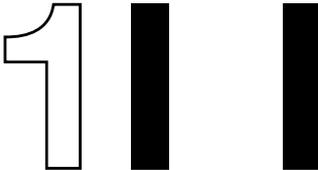
Dated _____ Signature _____

Notes:

- You may if you wish delete the words "Chairman of the meeting" and insert the name of the proxy or proxies of your choice in the space provided. Please initial such alteration.
- If no indication is given as to how you wish your proxy to vote, your proxy will vote or abstain as he/she thinks fit. On any other business arising at the meeting (including any motion to adjourn the meeting) the proxy will act at his/her discretion.
- In the case of joint holders, the signature of any one of them will be accepted but the signature of the senior of the joint holders shall be accepted to the exclusion of the others, seniority being determined by the order in which the names appear in the register of members of the Company.
- In the case of a corporation, this Form of Proxy should be executed under its common seal or under the hand of an officer, attorney of other person duly authorised on its behalf.
- Forms of Proxy signed by other than the registered holder will not be valid unless accompanied by the power of attorney (if any) or other authority under which it is signed or a notarially certified copy thereof.
- To be effective, Forms of Proxy must be lodged with Neville Registrars Limited, 18 Laurel Lane, Halesowen, West Midlands, B63 3BR not less than 48 hours before the time appointed for the meeting. Completion of this form of proxy will not prevent the holder from attending and voting at the meeting in person should he so wish.
- As permitted by Regulation 41 of the Uncertificated Securities Regulations 2001, members must be entered on the Company's register of members at 5 pm on 19 January 2004 in order to be entitled to attend and/or vote at the meeting in respect of the number of shares registered in their name at such time. Changes to entries on the register of members after that time will be disregarded in determining the rights of any person to attend and/or vote at the meeting.

SECOND FOLD

BUSINESS REPLY SERVICE
Licence No: 3865



Neville Registrars Limited
18 Laurel Lane
Halesowen
West Midlands
B63 3BR

FIRST FOLD

THIRD FOLD, THEN TUCK IN FLAP & TAPE ALONG EDGE



Product update

GAMES

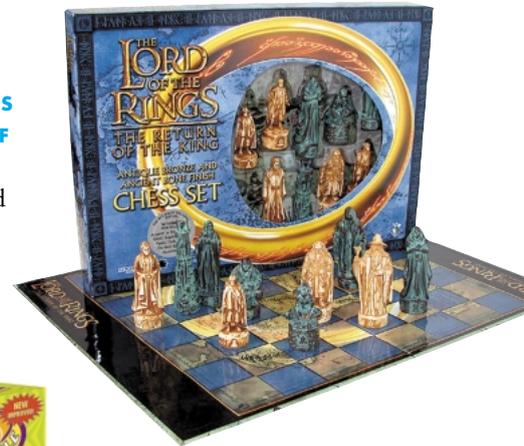
ELECTRONIC HUNGRY HUEY

Launched simultaneously around Europe, this Vomtastic Gastric Action Game has been a hit everywhere.



LORD OF THE RINGS CHESS - RETURN OF THE KING

A new edition for the 3rd Movie featuring new characters and a new antique style finish.



ELECTRONIC SLAPZ

The Classic playground game of knuckles/slappies with an electronic twist was one of Character Games most successful introductions in 2003.



ELECTRONIC SPIN THE BOTTLE

In it's 7th successful year, part of Character Games growing library of valuable copyrights.

GIFTS

LIGHT UP PENS

Excellent counter displays. The tops of these pens light up to enhance the design feature. Now a proven concept, expanding to licensed characters for 2004. A consistent 'top-seller'.



SPONGEBOB SQUAREPANTS

SpongeBob is an incurable optimist who lives at the bottom of the sea with his friends. Wonderful humour appeal to all ages. On TV and satellite channels, plus 'SpongeBob The Movie' due for release in 2004



HUGS

Perfect 'impulse' gift for someone special. A range of designs in different displays that say "you care". Ideal for Valentines Day, Mothers Day and everyday Hugs that capture those 'special feelings'.



HAND PAINTED GLASSWARE

A wonderful selection of glassware to celebrate special occasions and birthdays. Beautifully presented in gift packaging, this range will be further extended in 2004.

The Character Group plc

2nd Floor, 86-88 Coombe Road
New Malden, Surrey KT3 4QS

T 020 8949 5898

F 020 8336 2585

E info@charactergroup.plc.uk

A close-up, angled view of a silver mobile phone. The phone's surface is highly reflective, showing a bright diagonal highlight. A black rectangular sticker is affixed to the side of the phone, featuring the text '3.1 MEGA PIXEL' in white. The '3.1' is in a large, bold font, with 'MEGA' and 'PIXEL' stacked vertically below it. The phone's top edge shows a metallic ring and two small circular indentations. The bottom right corner of the image shows the edge of a camera lens.

3.1
MEGA
PIXEL