

contents

Page:

2	Chairman's statement
3	Directors and advisors
4	Directors, senior management & board committees
5	Directors' report
8	Financial review
9	Corporate governance
11	Statement of directors' responsibilities
12	Report of the independent auditors
13	Consolidated profit and loss account
13	Statement of total recognised gains and losses
14	Balance sheets
15	Consolidated cash flow statement
16	Notes to the accounts
26	Notice of annual general meeting

chairman's statement

The year under review has seen a continuation of the progress reflected in the Interim Statement, with a further increase in turnover and a welcome turnaround from a substantial loss to a profit.

Results

Turnover for the year ended 31 March 2004 was £1,858,000 compared with £1,702,000 in the prior year, an increase of 9.2%. The profit, both before and after tax, for the year was £107,000 (2003: loss before tax £582,000, loss after tax £484,000).

No dividend is proposed for the year (2003: £nil).

Operating Review and Current Developments

The worldwide release of Rogue Ops, a stealth-action adventure game developed for Sony's PlayStation 2, Microsoft's Xbox and Nintendo's GameCube, took place during the year. Although sales of the game did not meet our or the publisher's expectations, the title enhanced the Company's reputation as a developer of high quality video games, having been delivered on time and within budget.

As we announced in May 2004, Bits has been granted the licence to develop a video game for the upcoming Warner Bros. Pictures film "Constantine" and to publish and distribute the game together with a publisher to be approved by Warner Bros and ourselves. The game is based on the major film release of the same name featuring John Constantine, the compelling lead character in DC Comics/Vertigo publication, Hellblazer. The game features an original storyline based around the film and is being developed for Sony's PlayStation2 and Microsoft's Xbox.

Most recently, we were delighted to announce the agreement entered into with SCi Games to publish "Constantine". The game is already well into development and will be released to coincide with the film release in 2005. The advances being received from SCi in relation to "Constantine" are enhancing the Group's cash flow.

Staff

The staff have continued to make a significant contribution to the Group's success, and the board of directors thank our dedicated employees for their wonderful efforts during the year.

Prospects

The Group remains focused on its core activity, the design and development of video games for all next generation games consoles. In addition, other ventures are also being actively pursued.

I am confident that Bits will continue to go from strength to strength under the inspiring leadership of our Chief Executive, Foo Katan, and his dedicated team.

John Corre

Chairman

1 September 2004

directors and advisors

Directors

John H Corre FCA	Non-executive chairman
Fouad ("Foo") M A Katan	Chief executive/Managing director
M Robert Hakim FCA	Finance director
Julian I Levy FCA	Non-executive director

Secretary

M Robert Hakim FCA

Registered office

112 Cricklewood Lane, Cricklewood, London NW2 2DP

Company number

4064683

Financial Advisors and Stockbrokers

Collins Stewart plc, 9th Floor, 88 Wood Street, London EC2V 7QR

Auditors

Auerbach Hope, 58-60 Berners Street, London W1T 3JS

Solicitors

Jones Day, 21 Tudor Street, London EC4Y 0DJ

Bankers

Allied Irish Bank (GB), Mayfair Branch, 10 Berkeley Square, London W1J 6AA

Registrars

Capita IRG plc, Balfour House, 390/398 High Road, Ilford, Essex IG1 1NQ

directors, senior management & board committees

Board of directors

John Corre - Non-Executive Chairman

John (60) qualified as a chartered accountant with Auerbach Hope and went on to become senior partner up until 1993. Based in Israel he is involved with a number of private venture capital and technology companies. He is currently chairman of Selector Ltd, an Israeli company quoted on the AiM market of the London Stock Exchange.

Foo Katan - Chief Executive and Managing Director

Foo (38) has been involved in the computer games business for over 19 years. Foo set up the business in 1984 and has been involved in computer game development ever since, building long-standing working relationships with a number of the leading computer game companies, such as Nintendo and Sony. He is involved in all game development contract negotiations and acts as Executive Producer on all games being developed by the Group.

Robert Hakim - Finance Director

Robert (35) qualified as a chartered accountant with Gerald Edelman in 1992. After spending 3 years with Neville Russell, he joined Sterling Underwriting Agencies Limited, a Lloyd's managing agent, as finance director designate. He joined Bits in December 1999 and is responsible for all financial aspects of the business.

Julian Levy - Non-Executive Director

Julian (40) qualified as a chartered accountant with BDO Stoy Hayward and has held venture capital and investment banking positions with WestLB, amongst others. Julian was the finance director of Eidos plc, the computer games publisher and developer, from 1993 to 1996. He is currently CFO of Optimad Media Systems, a managed software provider for the media industry backed by 3i plc and Digital Mountain AG.

Senior management

Mario Aguera - Studio Director

Mario (34) joined Bits in 1998 and worked as producer on Die Hard: Vendetta. Following successful completion of the title in 2002, he was appointed Studio Director. Mario is responsible for creative development of all the Group's games, working closely with the design team on the initial direction through to providing support during project development.

Jérôme Muffat-Méridol - Technical Director

Jérôme (38) has spent over 14 years working in both traditional and games software companies. He joined Bits in August 1998 from an Internet start-up company based in France. Jérôme is responsible for the development and selection of new standard game tools and technologies, adopting a hands-on approach where necessary to keep up to date with the Group's needs.

Board committees

The principal standing committees appointed by the Board are as follows:

Audit Committee

The Audit Committee members are John Corre (Chairman), Foo Katan and Julian Levy. The Committee meets at least twice a year to review the Group's financial statements, internal financial control, financial reporting and accounting policies. The Group's external auditors are invited to attend each meeting. The finance director attends when requested by the Committee.

Remuneration Committee

The Remuneration Committee members are John Corre (Chairman), Foo Katan and Julian Levy. The Committee meets at least twice a year to review the remuneration of the executive directors.

Full details of directors' remuneration and a statement of the Company's remuneration policy is set out in the Directors' Report appearing on pages 5 to 7. The Chief Executive attends meetings of the Committee to discuss the performance of the other executive director and make proposals as necessary, but is not present when his own position is being discussed.

Each executive director abstains from any discussion or voting at full Board meetings on Remuneration Committee recommendations where the recommendations have a direct bearing on his own remuneration package. The details of each executive director's individual package are fixed by the Committee in line with the policy adopted by the full Board.

directors' report

The directors present their report together with the audited financial statements for the year ended 31 March 2004.

Principal activities, business review and future developments

The principal activity of the Group is the design and development of computer games software.

A detailed review of the business, together with the outlook for the future, is contained in the Chairman's statement on page 2 and the Financial Review on page 8.

Results and dividends

The results of the Group for the year are set out on page 13 and show a profit for the year of £107,000 (2003 - loss £484,000).

The directors do not propose that a dividend be paid for this year (2003 - £nil).

Substantial interests in share capital

As at 9 August 2004, the directors are aware of the following:

Name	Holding	%
Chargegovern Limited	1,989,601	4.52
JP Morgan Fleming Asset Management Limited	8,000,000	18.19
I Robot Holdings Limited	13,356,000	30.36
Fouad Katan and Barnett Waddingham Trustees Ltd as Trustees of the Mikto Pension Scheme	2,613,750	5.94
N.Y. Nominees Limited	6,189,213	14.07

Other than disclosed above, the directors are not aware of any other person holding an interest of 3% or more of the Company's ordinary share capital.

Policy on the payment of creditors

It is the policy of the Group to settle the terms of payment with all suppliers when agreeing the terms of each transaction; to ensure that those suppliers are made aware of the terms of payment; and to abide by these terms. Creditor days at the year end for the Company were 114 days (2003 - 132 days) and for the Group were 40 days (2003 - 70 days).

Directors

The names of the current directors of the Company and their biographical details are given on page 4.

The directors retiring by rotation at the forthcoming Annual General Meeting are Foo Katan and Robert Hakim who, being eligible, offer themselves for re-election. All of the directors serve the Group under contracts which are terminable on notice of 12 months or less.

Directors' interests

Set out below are the beneficial interests of the directors and their immediate families in the Company's ordinary shares as at 31 March 2004 and at 31 March 2003.

	At 31 March 2004	At 31 March 2003
John Corre	-	-
Foo Katan	1,060,000	1,060,000
Robert Hakim	8,851	8,851
Julian Levy	568,000	568,000

In addition to his holding above, Foo Katan (together with members of his family) is a potential beneficiary of a discretionary settlement which controls the issued share capital in I Robot Holdings Limited. I Robot Holdings Limited holds 13,356,000 ordinary shares. Foo Katan is not in a position by virtue of the discretionary settlement to exercise or cause the exercise, directly or indirectly, of voting rights for or against resolutions to be passed at shareholders' meetings of the company. Foo Katan is also interested in the 1,989,601 ordinary shares held by Chargegovern Limited, a company in which he is the sole director. In addition, Foo Katan is the sole beneficiary of the Mikto Pension Scheme, a pension fund which holds 2,613,750 ordinary shares.

1,060,000 ordinary shares are held by Fluxon Investments Limited, which is controlled by a discretionary settlement, under which Julian Levy (together with members of his family) is a potential beneficiary. Julian Levy is not in a position by virtue of the discretionary settlement to exercise or cause the exercise, directly or indirectly, of voting rights for or against resolutions to be passed at shareholders' meetings of the company.

There have been no changes in the above shareholdings between 31 March 2004 and 9 August 2004.

The Group's principal premises are at Ground Floor, 112 Cricklewood Lane, London NW2 2DP ("the Property"). The freehold of the Property is owned jointly by the Mikto Pension Scheme and by Vexford Properties Limited. Foo Katan is the beneficiary of the Mikto Pension Scheme. Foo Katan (together with members of his family) is a potential beneficiary of a discretionary settlement which controls the issued share capital in Vexford Properties Limited. The Company's subsidiary, Bits Studios Limited, has entered a lease for a term of 6 years commencing 1 November 1999 at a rent of £57,000 per annum, with the option to renew this at the completion of this term. The profit and loss account has been charged with £57,000 for rent for the year (2003 - £57,000). During the year Bits Studios Limited did not make any rental payments to the acting managing agent of the Property, Chargegovern Limited, a company in which Foo Katan has a controlling interest (2003 - £171,000).

Company policy on the remuneration of executive directors

The objective of the Group's remuneration policy is to provide a level of remuneration which will attract, retain and motivate executive directors and senior management of the highest calibre.

Performance related bonuses are payable in addition to basic salaries. These bonuses are based upon individual objectives as well as the Group's performance in terms of profit before tax, earnings per share and cash flow management.

Share options and other incentives are also used as part of the Group's remuneration policy.

An analysis of directors' remuneration is set out below:

	Basic Salary 2004 £'000	Bonus 2004 £'000	Benefits in kind 2004 £'000	Fees 2004 £'000	Total emoluments 2004 £'000	2003 £'000
John Corre	-	-	-	19	19	19
Foo Katan	93	-	1	-	94	92
Robert Hakim	64	-	-	-	64	64
Julian Levy	19	-	-	-	19	19
	176	-	1	19	196	194

directors' report *(continued)*

Share options

The Group believes that share ownership by executive directors strengthens the link between their personal interests and those of shareholders. Shares granted under the Group's option schemes have been granted under the auspices of the Remuneration Committee to attract, maintain and motivate executive directors and to reflect their individual performance. The share options of the individual directors are set out below:

	At 1 April 2003 Number	Options granted Number	At 31 March 2004 Number	Exercise price (pence)	Date from which exercisable	Date of expiry
John Corre	50,000	-	50,000	60.00	Sep 2001	Sep 2004
	30,000	-	30,000	17.25	Dec 2004	Dec 2011
Robert Hakim	1,060,000	-	1,060,000	9.43	Dec 2002	Dec 2006
	30,000	-	30,000	13.75	Aug 2004	Aug 2011
Julian Levy	30,000	-	30,000	17.25	Dec 2004	Dec 2011

No options lapsed in the year. The market price of the shares at 31 March 2004 was 2.62p and the range during the financial year was 1.87p to 6.00p. There have been no changes in the directors' beneficial interests between 31 March 2004 and 9 August 2004.

Auditors

Auerbach Hope have expressed their willingness to continue in office and a resolution to re-appoint them will be proposed at the Annual General Meeting.

By order of the Board

Robert Hakim
Company Secretary

1 September 2004

financial review

Results from operations

The Group produced an operating profit of £98,000 for the year ended 31 March 2004.

Milestone revenue increased by 7% compared with the previous period and modest royalties were earned on Die Hard Vendetta during the year.

Cash flow

The cash outflow from operating activities was £22,000 and capital expenditure absorbed was £14,000. Net interest of £9,000 was received during the year. At the year end, cash balances amounted to £179,000.

Going concern

Given the cash balances held at 31 March 2004 and based on the plans for the next period, the directors have a reasonable expectation that the Company will have adequate resources to continue operations for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Euro note

The Group's objective is for all relevant subsidiaries to be able to handle business in Euros when required. A Group-wide accredited Euro-compliant accounting system has been established to meet this objective.

Financial instruments

The Group's financial instruments comprise cash and various items such as trade debtors and trade creditors that arise directly from its operations. The main risks from the Group's financial instruments are liquidity risk and currency risk. These risks are summarised below.

Liquidity risk

During the period under review the Group's operations were funded by the issue of ordinary shares. The Group has an unutilised overdraft facility and does not have any other borrowings. However, the Board has the ability to raise further funds by the issue of shares up to an aggregate nominal value of £60,000.

Currency risk

100% of the Group's sales are transacted in foreign currency, predominantly in US Dollars. During the year the Group entered into forward currency contracts to minimise its currency exposure. It is the Group's policy to review currency risks as and when transactions in foreign currencies take place and to provide hedges where appropriate.

Robert Hakim

Finance Director

1 September 2004

corporate governance

The directors recognise the value of the Principles of Good Governance and Code of Best Practice (the "Combined Code") and although, as an AiM listed company, Bits is not required to comply with the Combined Code, it is taking appropriate measures to ensure that the Group adopts those principles of the Combined Code that the Board considers are appropriate for a Group of its size.

The statement set out below describes how the principles identified in the Combined Code (appended to the Listing Rules) are applied by the Group.

Directors

The Board consists of a non-executive Chairman, John Corre, a non-executive director and two other executive directors, of which Foo Katan is the Chief Executive. The non-executive directors, John Corre and Julian Levy, are considered by the Board to be independent of management and free of any relationship which could materially interfere with the exercise of their independent judgement. Their interests in the shares of the Company are set out on page 6 and they receive a fixed fee for their services.

Biographies of the Board members appear on page 4 of this report. These indicate the high level and range of business experience which enables the Group to be managed effectively.

The Board meets at least eight times a year and more frequently where business needs require. The Board has a schedule of matters reserved to it for decision and the requirement for Board approval on these matters is communicated widely throughout the senior management of the Group. This includes matters such as material capital commitments, commencing or settling major litigation, business acquisitions and disposals and Board appointments.

There is an agreed procedure for directors to take independent professional advice if necessary and at the Company's expense. This is in addition to the access which every director has to the Company Secretary. The Secretary is charged by the Board with ensuring that Board procedures are followed.

The differing roles of the Chairman and Chief Executive are acknowledged and defined in separate statements approved by the Board. The key functions of the Chairman are to conduct Board meetings and meetings of shareholders and to ensure that all directors are properly briefed in order to take a full and constructive part in Board discussions. The Chief Executive is required to develop and lead business strategies and processes to enable the Group's business to meet the requirements of its shareholders.

The senior non-executive director is the Chairman, John Corre, and concerns relating to the executive management of the Company or the performance of the other non-executive director may be raised with him.

To enable the Board to function effectively and directors to discharge their responsibilities, full and timely access is given to all relevant information. In the case of Board meetings, this consists of a comprehensive set of papers, including regular business progress reports and discussion documents regarding specific matters.

Appointments to the Board of both executive and non-executive directors are considered by the full Board. The Board considers that there is no current requirement for a Nomination Committee in view of the size of the Board. The Remuneration Committee considers any remuneration package before it is offered to a potential appointee.

Communication

The Company places a great deal of importance on communication with its shareholders. The full report and accounts are available to all shareholders on request and to other parties who have an interest in the Group's performance. Shareholders also have direct access to the Company via its website and the Company responds to numerous letters and emails from shareholders and others on a wide range of issues.

There is the opportunity for regular dialogue with individual institutional shareholders as well as general presentations after the interim and preliminary results. All shareholders have the opportunity to put questions at the Company's Annual General Meeting and the Company makes a presentation at the meeting to highlight the key business developments during the financial year.

Audit and internal control

The respective responsibilities of the directors and the auditors in connection with the accounts are explained on pages 11 and 12.

The Board considers risk management and internal control on a regular basis during the year. The directors are responsible for the Group's system of internal financial control which is designed to provide reasonable but not absolute assurance against material misstatement or loss. The key procedures that the directors have established to provide effective internal financial controls are as follows:

Control environment: Each project team has its own management which meets regularly to monitor and discuss all operational matters. These management teams report directly to the Group Chief Executive. Clearly defined lines of responsibility and delegation of authority have been established within the Group's organisational structure. The executive directors visit all project teams regularly to review operating procedures and activities.

Risk management: Both Group and project team management have a clear responsibility for identifying risks to business and for establishing procedures to mitigate and monitor such risks.

Financial reporting: A detailed formal budgeting process for all Group businesses culminates in an annual Group budget which is approved by the Board. Results for the Group and for its main constituent businesses are reported monthly against this budget to the Board and revised forecasts for the year are prepared periodically.

Capital investment: The Group has clearly defined guidelines for capital expenditure. These include annual budgets, detailed appraisal and review procedures, and due diligence requirements where businesses are being acquired. Post investment appraisals are performed for major investments.

The Audit Committee on behalf of the Board has reviewed the effectiveness of the system of internal financial control from the information provided by management and the Group's external auditors. Any system of internal financial control can only provide reasonable and not absolute assurance of meeting the internal control objectives.

The Audit Committee keeps the scope and cost effectiveness of the external audit under review. The independence and objectivity of the external auditors is also considered on a regular basis, with particular regard to the level of non-audit fees. The split between audit and non-audit fees for the year under review appears on page 18. The non-audit fees were paid in respect of tax advice and are considered by the Committee not to affect the external auditors' independence or integrity.

By order of the Board

Robert Hakim
Company Secretary

1 September 2004

statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Group for that period. In preparing those financial statements, the directors are required to:

- (i) select suitable accounting policies and then apply them consistently;
- (ii) make judgements and estimates that are reasonable and prudent;
- (iii) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- (iv) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

report of the independent auditors

To the shareholders of Bits Corp plc

We have audited the financial statements of Bits Corp plc on pages 13 to 25 for the year ended 31 March 2004. These financial statements have been prepared in accordance with the applicable accounting standards, under the historical cost convention and the accounting policies set out therein.

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

As described in the statement of Directors' responsibilities on page 11 the Company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are 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 financial statements, 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 Group is not disclosed.

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report, the Chairman's Statement, the Financial Review 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 financial statements. Our responsibilities do not extend to any other information.

Basis of 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 financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group'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 financial statements 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 financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the Company and the Group as at 31 March 2004 and of the result of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

AUERBACH HOPE

Chartered Accountants and Registered Auditors
London

1 September 2004

consolidated profit and loss account

for the year ended 31 march 2004

	Notes	2004 £'000	2003 £'000
Turnover	2	1,858	1,702
Cost of sales		(1,420)	(1,920)
Gross profit/(loss)		438	(218)
Distribution costs		(6)	(10)
Administrative expenses		(334)	(350)
Operating profit/(loss)		98	(578)
Interest receivable	3	9	6
Profit/(Loss) on ordinary activities before tax	4	107	(572)
Tax on profit/(loss) on ordinary activities	6	-	88
Profit/(Loss) retained for the year	16	107	(484)
Earnings/(Loss) per share - basic	7	0.25p	(1.29p)

The results relate wholly to continuing operations.

There is no material difference between the results stated above and the results shown on a historical basis.

statement of total recognised gains and losses

for the year ended 31 march 2004

	2004 £'000	2003 £'000
Profit/(Loss) for the year	107	(484)
Currency translation differences	11	(40)
Total recognised gains and losses relating to the year	118	(524)

The notes on pages 16 to 25 form part of these financial statements.

balance sheets

at 31 march 2004

	Notes	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Fixed assets					
Intangible assets	9	-	254	-	-
Tangible assets	10	20	68	-	-
Investments	11	-	-	249	249
		20	322	249	249
Current assets					
Debtors	12	916	1,014	3,951	3,969
Cash at bank and in hand		209	12	88	-
		1,125	1,026	4,039	3,969
Creditors: amounts falling due within one year	13	(508)	(965)	(23)	(72)
Net current assets		617	61	4,016	3,897
Net assets		637	383	4,265	4,146
Capital and reserves					
Called up share capital	15	440	415	440	415
Share premium account	16	3,830	3,719	3,830	3,719
Merger reserve	16	735	735	-	-
Profit and loss account	16	(4,368)	(4,486)	(5)	12
Shareholders' funds - equity		637	383	4,265	4,146

These financial statements were approved by the Board on 1 September 2004 and signed on its behalf by:

Foo Katan, Chief Executive
Robert Hakim, Finance Director

The notes on pages 16 to 25 form part of these financial statements.

consolidated cash flow statement

for the year ended 31 march 2004

	Notes	2004 £'000	2003 £'000
Net cash outflow from operating activities	21	(22)	(888)
Returns on investments and servicing of finance			
Interest received		9	6
		9	6
Taxation			
Corporation tax repaid		47	88
		47	88
Capital expenditure			
Purchase of tangible fixed assets		(14)	(49)
		(14)	(49)
Net cash inflow/(outflow) before use of liquid resources and financing		20	(843)
Management of liquid resources			
Movement in short term bank deposits		(207)	480
		(207)	480
Financing			
Issue of ordinary share capital		100	390
Expenses paid in connection with share issue		-	(52)
VAT reclaim on expenses paid in connection with share issues		36	-
		136	338
Decrease in cash in the year	22	(51)	(25)

The notes on pages 16 to 25 form part of these financial statements.

notes to the accounts

1 Accounting policies

The financial statements have been prepared under the historical cost convention. The following principal accounting policies have been applied and are in accordance with applicable accounting standards.

Basis of consolidation

The consolidated financial statements incorporate the results of the Company and all of its subsidiaries for the relevant accounting periods. The Group acquired Bits Studios Limited on 5 September 2000, which is being consolidated using the merger method of accounting.

Merger accounting

Where merger accounting is used, the investment is recorded in the Company's balance sheet at the nominal value of the shares issued together with the fair value of any additional consideration paid.

In the Group financial statements, merged subsidiary undertakings are treated as if they had always been a member of the Group. The results of such subsidiary are included for the whole period in the year it joins the Group. The corresponding figures for the previous year include its results for that period, the assets and liabilities at the previous balance sheet date and the shares issued by the Company as consideration as if they had always been in issue. Any difference between the nominal value of the shares acquired by the Company and those issued by the Company to acquire them is taken to reserves.

Turnover

Turnover represents amounts receivable for goods and services net of VAT and trade discounts. Turnover is ascertained in a manner appropriate to the stage of completion of the contract and the industry in which it operates.

Depreciation

Depreciation is provided at rates calculated to write off the cost less estimated residual value of all tangible fixed assets over their expected useful lives as follows:

Fixtures, fittings & equipment	50% per annum straight line
--------------------------------	-----------------------------

Amortisation

Amortisation is provided at rates calculated to write off the cost less estimated residual value of all intangible fixed assets over their expected useful lives as follows:

Software licenses	32.67% per annum straight line
-------------------	--------------------------------

Leasing and hire purchase commitments

Assets obtained under hire purchase contracts and finance leases are capitalised as tangible assets and depreciated over the shorter of the lease term and their useful lives. Obligations under such agreements are included in creditors net of finance charges allocated to future periods. The finance element of the rental payment is charged to the profit and loss account in order to produce a constant periodic rate of charge on the net obligations outstanding in each period.

All other leases are treated as operating leases. Their annual rentals are charged to the profit and loss account on a straight line basis over the term of the lease.

notes to the accounts *(continued)*

1 Accounting policies *(continued)*

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed by the balance sheet date except for deferred tax assets, which are only recognised to the extent that the Group anticipates making sufficient taxable profits in the future to absorb the reversal of the underlying timing differences. Deferred tax balances are not discounted.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. All differences are taken to the profit and loss account.

The results of overseas operations and their balance sheets are translated into Sterling at the rates of exchange ruling on the balance sheet date. Exchange differences that arise from translation of the opening net assets in foreign subsidiary undertakings are taken to reserves.

Profit recognition on contracting activities

In accordance with Statement of Standard Accounting Practice 9, long term contracts are assessed on a contract by contract basis and reflected in the profit and loss account by recording turnover and related costs as contract activity progresses. Profit on individual contracts is taken only when their outcome can be foreseen with reasonable certainty. It is apportioned on the basis of the stage of completion of the contract at the year end.

Full provision is made for all known or expected losses as soon as they are foreseen.

2 Turnover

All turnover arose from operations in the UK and from one class of business - the development of games software.

Turnover by type was as follows:

	2004	2003
	£'000	£'000
Amounts receivable under development contracts	1,828	1,702
Royalties	30	-
	1,858	1,702

Turnover by geographical market was as follows:

	2004	2003
	£'000	£'000
United Kingdom	661	-
France	178	769
USA	-	196
Rest of World	1,019	737
	1,858	1,702

3 Interest receivable

	2004	2003
	£'000	£'000
Bank interest receivable	9	5
Other interest receivable	-	1
	9	6

4 Profit/(Loss) on ordinary activities before tax

This is stated after charging/(crediting) the following:

	2004	2003
	£'000	£'000
Amortisation on intangible fixed assets	254	204
Depreciation on tangible fixed assets	62	133
Hire of equipment	2	3
Other operating leases	57	57
Auditors' remuneration - audit services (Company £nil (2003 - £nil))	16	18
- non-audit services (see below)	1	(1)
Loss/(Profit) on foreign exchange	50	(66)

5 Employees

	2004	2003
	£'000	£'000
The payroll costs (including directors) were as follows:		
Wages and salaries	1,093	1,334
Social security costs	119	144
	1,212	1,478

Details of directors' remuneration are shown in the Directors' Report on pages 6 and 7.

The average number of people (including executive directors) employed by the Group was as follows:

	2004	2003
	Number	Number
Development	32	39
Management and administration	4	6
	36	45

notes to the accounts *(continued)*

6 Tax on profit/(loss) on ordinary activities

(a) Analysis of charge in period

	2004	2003
	£'000	£'000
Current tax	-	(88)
Total current tax (note 6(b))	-	(88)

(b) Factors affecting tax charge for period

The tax assessed for the period is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2004	2003
	£'000	£'000
Profit/(Loss) on ordinary activities before tax	107	(572)
Profit/(Loss) on ordinary activities multiplied by standard rate of UK corporation tax of 30%	32	(172)
Effects of:		
Expenses not deductible for tax purposes	50	63
Other short term timing differences	11	11
Utilisation of tax losses	(8)	-
Increase in available tax losses	-	98
Other	(85)	-
Adjustments to tax charge in respect of previous periods	-	(88)
Current tax charge for period (Note 6(a))	-	(88)

7 Earnings/(Loss) per share

The calculation of basic earnings is based on the profit after taxation of £107,000 (2003 - loss £484,000) by reference to the 42,263,548 (2003 - 37,458,128) weighted average ordinary shares in issue during the period. As the Company's market share price is lower than the exercise price of all options currently in issue, none of the Company's potential ordinary shares are dilutive and therefore the earnings per share is the same as the diluted earnings per share.

8 Profit for the financial year

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the parent company is not presented as part of these accounts. The parent company loss for the financial year amounted to £18,000 (2003 - loss £25,000).

9 Intangible assets

Group	Software licenses £'000
Cost	
At 1 April 2003	625
Additions	-
Disposals	-
At 31 March 2004	625
Amortisation	
At 1 April 2003	371
Charge for the period	204
Diminution in value	50
Disposals	-
At 31 March 2004	625
Net book values	
At 31 March 2004	-
At 31 March 2003	254

In the directors' opinion, the software license previously capitalised has no future expected economic value and therefore has been written off in full.

10 Tangible assets

Group	Fixtures, fittings and equipment £'000
Cost	
At 1 April 2003	492
Additions	14
Disposals	-
At 31 March 2004	506
Depreciation	
At 1 April 2003	424
Charge for the period	62
Disposals	-
At 31 March 2004	486
Net book values	
At 31 March 2004	20
At 31 March 2003	68

notes to the accounts *(continued)*

11 Fixed asset investments

Company	Group undertakings Shares £'000
Cost	
At 1 April 2003	249
Additions	-
At 31 March 2004	249
Amounts written off	
At 1 April 2003	-
Provided in the period	-
At 31 March 2004	-
Net book values	
At 31 March 2004	249
At 31 March 2003	249

Subsidiary undertakings

The following were subsidiary undertakings at the year end and have all been included in the consolidated financial statements:

Name	Country of incorporation or registration	Ordinary share capital held	Nature of business
Bits Studios Limited	England	100.0%	Computer games software
Games Magnet Limited	*England	96.5%	Computer games software
BSF335 SARL	**France	100.0%	Non-trading

* Owned by intermediate holding company, Bits Studios Limited.

** 98.75% owned by intermediate holding company, Bits Studios Limited.

All of the above Companies' main operations are in the UK with the exception of BSF335 SARL, whose main operations were in France. BSF335 SARL ceased to trade on 30 November 2002.

13 Debtors

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Trade debtors	214	358	-	-
Amounts owed by Group undertakings	-	-	3,944	3,963
Other debtors	8	9	3	2
Prepayments and accrued income	33	34	4	4
Amounts receivable on contracts	661	613	-	-
	916	1,014	3,951	3,969

All amounts fall due within one year.

13 Creditors: amounts falling due within one year

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Bank overdraft	30	-	1	-
Trade creditors	65	134	22	72
Other creditors	6	8	-	-
Taxation and social security	83	109	-	-
Accruals and deferred income	324	616	-	-
Amounts received in advance on contracts	-	98	-	-
	508	965	23	72

14 Deferred taxation

The potential deferred tax asset of the Group arising from tax losses carried forward net of the excess of capital allowances over depreciation is set out below. As the recoverability of this amount in the foreseeable future is uncertain, the potential deferred tax asset has not been recognised. The Company has no potential deferred tax assets or liabilities.

	Group 2004 £'000	Group 2003 £'000
Tax losses carried forward	1,414	1,422
Excess/(Shortfall) of depreciation over capital allowances	2	(10)
Other timing differences	-	85
	1,416	1,497

15 Share capital and share premium

Authorised	2004 Number	2003 Number
Ordinary shares of 1p each	50,000,000	50,000,000

During the year ordinary shares were allotted as follows:

Group and Company	Ordinary shares of 1p each Number	Issued share capital £'000	Share premium account £'000
Allotted, called up and fully paid			
At 1 April 2003	41,491,690	415	3,719
Placing of shares in December 2003	2,500,000	25	75
Reclaim of VAT on share issue expenses	-	-	36
At 31 March 2004	43,991,690	440	3,830

On 10 December 2003, 2,500,000 ordinary shares were issued for cash at a price of 4p each.

notes to the accounts *(continued)*

15 Share capital and share premium *(continued)*

At 31 March 2004 the following share options were outstanding:

Year of grant	Number of shares	Period of option	Price per share
1997	129,850	Nov 2000 - Nov 2004	9.434p
1999	34,450	Jan 2002 - Jan 2006	9.434p
1999	116,600	Aug 2002 - Aug 2006	9.434p
1999	1,148,775	Dec 2002 - Dec 2006	9.434p
2000	92,750	Feb 2003 - Feb 2007	22.642p
2000	18,550	Apr 2003 - Apr 2007	22.642p
2000	50,000	Sep 2001 - Sep 2004	60.000p
2000	212,240	Sep 2003 - Sep 2010	60.000p
2001	165,000	Aug 2004 - Aug 2011	13.750p
2001	60,000	Dec 2004 - Dec 2011	17.250p

16 Statement of movement on reserves

	Group Merger reserve £'000	Group Share premium £'000	Group Profit and loss account £'000	Company Share premium £'000	Company Profit and loss account £'000
At 1 April 2003	735	3,719	(4,486)	3,719	12
Premium on issue of shares	-	75	-	75	-
Reclaim of VAT on share issue expenses	-	36	-	36	-
Profit/(Loss) for the period	-	-	107	-	(17)
Currency translation differences	-	-	11	-	-
At 31 March 2004	735	3,830	(4,368)	3,830	(5)

17 Reconciliation of movements in shareholders' funds

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Share capital issued	100	338	100	338
Reclaim of VAT on share issue expenses	36	-	36	-
Profit/(Loss) for the financial period	107	(484)	(17)	(25)
Currency translation differences	11	(40)	-	-
Net addition to/(reduction in) shareholders' funds	254	(186)	119	313
Opening shareholders' funds	383	569	4,146	3,833
Closing shareholders' funds	637	383	4,265	4,146

18 Capital commitments

The Group had no significant capital commitments at 31 March 2004 or 31 March 2003.

19 Commitments under operating leases

The Group has annual commitments in respect of operating leases as follows:

	2004	2003
	£'000	£'000
Leases expiring: between two and five years:		
Land and buildings	57	-
Other operating leases	1	2

20 Contingent liabilities

The Company

The Company is registered with Customs and Excise as a member of a group for VAT purposes and as a result is jointly and severally liable on a continuing basis for amounts owing by any other member of the Group in respect of unpaid Value Added Tax. At 31 March 2004 the VAT liability was £nil (2003 - £nil).

21 Reconciliation of operating profit/(loss) to net cash outflow from operating activities

	2004	2003
	£'000	£'000
Operating profit/(loss)	98	(578)
Depreciation and amortisation of fixed assets	316	337
Decrease/(Increase) in debtors	98	(609)
Decrease in creditors	(534)	(38)
Net cash outflow from operating activities	(22)	(888)

22 Reconciliation of net cash flow to movement in net funds

	2004	2003
	£'000	£'000
Decrease in cash in the period	(51)	(25)
Increase/(Decrease) in liquid resources	207	(480)
Change in net funds resulting from cash flows	156	(505)
Currency translation differences	11	(40)
Movement in net funds in the period	167	(545)
Opening net funds	12	557
Net funds at the end of the year	179	12

notes to the accounts *(continued)*

23 Analysis of net funds

	At 1 April 2003 £'000	Cash flow £'000	Translation differences £'000	At 31 March 2004 £'000
Cash at bank and in hand	12	(21)	11	2
Bank overdrafts	-	(30)	-	(30)
	12	(51)	11	(28)
Short term deposits	-	207	-	207
Total net funds	12	156	11	179

24 Financial instruments

A summary of the objectives and policies for holding or issuing financial instruments is given in the Financial Review on page 8. The numerical disclosures given in this note deal with financial assets and liabilities as defined by Financial Reporting Standard 13, Derivatives and Other Financial Instruments (FRS 13). As permitted by FRS 13, short-term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

The Group's financial assets consist of cash at bank and Sterling and US Dollar cash deposits of £209,000 (2003 - £12,000) including £207,000 (2003 - £nil) of cash placed on money market at treasury rates. There is no difference between the fair value and the book value of the financial assets.

The Group had no financial liabilities at 31 March 2004 other than a bank overdraft of £30,000 (2003 - £nil). There is no difference between the fair value and the book value of the financial liabilities.

Currency exposures

The Group's policy with respect to currency exposures is described in the Financial Review on page 8. The functional currency of the Group's operations is Sterling. At 31 March 2004 the Group's currency exposures, i.e. those exposures arising from transactions that give rise to the net currency gains and losses recognised in the profit and loss account, were net monetary assets denominated in US Dollars of £766,000 (2003 - £212,000) and in Euros of £nil (2003 - £129,000).

At 31 March 2004 the Group had no outstanding forward exchange contracts to sell US Dollars (2003 - US\$300,000) or to sell Euros (2003 - □450,000), falling due within one year.

25 Related party transactions

The Group's principal premises are at Ground Floor, 112 Cricklewood Lane, London NW2 2DP ("the Property"). The freehold of the Property is owned jointly by the Mikto Pension Scheme and by Vexford Properties Limited. Foo Katan is the beneficiary of the Mikto Pension Scheme. Foo Katan (together with members of his family) is a potential beneficiary of a discretionary settlement which controls the issued share capital in Vexford Properties Limited. The Company's subsidiary, Bits Studios Limited, has entered a lease for a term of 6 years commencing 1 November 1999 at a rent of £57,000 per annum, with the option to renew this at the completion of this term. The profit and loss account has been charged with £57,000 for rent for the year (2003 - £57,000). During the year Bits Studios Limited did not make any rental payments to the acting managing agent of the Property, Chargegovern Limited, a company in which Foo Katan has a controlling interest (2003 - £171,000).

notice of agm

Notice is hereby given that the Annual General Meeting of the shareholders of Bits Corp plc will be held at 11.00am on 22 November 2004 at 112 Cricklewood Lane, Cricklewood, London NW2 2DP for the following purposes:

Ordinary business

- 1 To receive and consider the financial statements and accounts of the Group and the reports of the directors and auditors for the year ended 31 March 2004.
- 2 To re-elect Foo Katan as a director of the Company.
- 3 To re-elect Robert Hakim as a director of the Company.
- 4 To re-appoint Auerbach Hope as auditors and to authorise the directors to fix their remuneration.
- 5 To increase the authorised share capital of the Company to 100,000,000 ordinary shares of 1p each

Special business

To consider and, if thought fit, pass the following special resolution.

- 6 That the directors be and they are hereby empowered, pursuant to Section 95 of the Companies Act 1985 ("The Act"), for the period commencing on the date this resolution is passed and expiring on the earlier of the date of the Annual General Meeting of the Company to be held in 2005 and 15 months from the date of this resolution, and at any time thereafter pursuant to any offer, agreement or other arrangement made by the Company before the expiry of this power, to allot, out of any relevant securities (as defined in Section 80(2) of the Act) which they are from time to time authorised to allot, and as if Section 89(1) of the Act did not apply to such allotment, equity securities as defined in Section 94(2) of the Act:
 - (i) in connection with an issue by way of rights (including, without limitation, under a rights issue, open offer or similar arrangement) to holders of equity securities (as so defined) in proportion as nearly as may be to their respective holdings of such securities or in accordance with the rights attaching thereto (but with such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, record dates or other legal or practical problems under the laws of, or the requirements of, any recognised regulatory body or any stock exchange in any territory or as regards shares held by an approved depository or an issue in uncertified form or otherwise);
 - (ii) otherwise than pursuant to (i) above, up to a maximum aggregate nominal value of £25,000.

By order of the Board

Robert Hakim
Company Secretary

1 September 2004

Registered office:
112 Cricklewood Lane
Cricklewood
London
NW2 2DP

Registered in England No. 4064683

notice of agm *(continued)*

Notes:

1. A member entitled to attend and vote at the Meeting may appoint a proxy or proxies to attend and, on a poll, vote instead of him or herself. The proxy need not be a member of the Company.
2. A form of proxy is provided. Proxies must be received at the office of the Company's Registrars, Capita IRG plc, Balfour House, 390/398 High Road, Ilford, Essex IG1 1NQ not less than 48 hours before the time fixed for the Meeting.
3. There will be available for inspection at the registered office of the Company during normal business hours from the date of this Notice to the date of the Annual General Meeting, and at the place of the Meeting for 15 minutes prior to and during the Meeting, the following:
 - a. The Register of directors' interests in shares of the Company; and
 - b. Copies of directors' contracts of service.

notes
