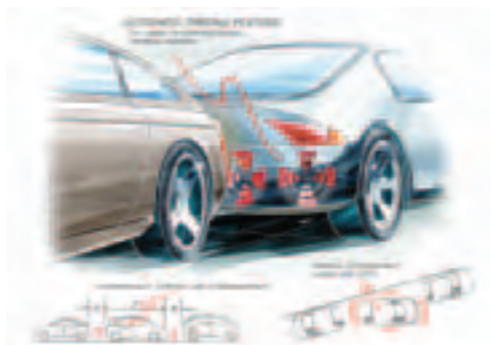




ANNUAL REPORT AND ACCOUNTS 2004

Torotrak is the world leader in the design and development of traction drive infinitely variable transmission (IVT) systems. Our technology offers the automotive industry significant improvements in fuel economy, performance and smoothness combined with innovative driving control features. Torotrak's principal commercial strategy is to generate royalty income from volume manufacture of its IVT by car companies and transmission suppliers.



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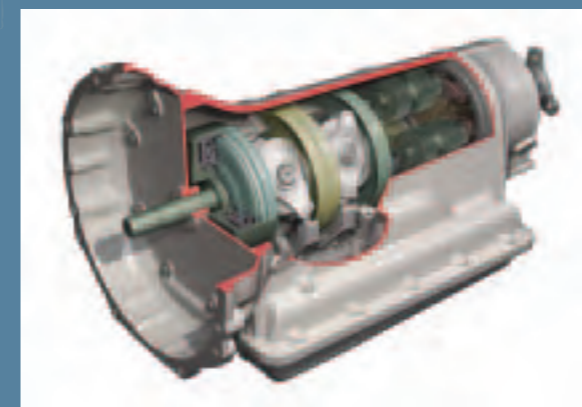
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highlights

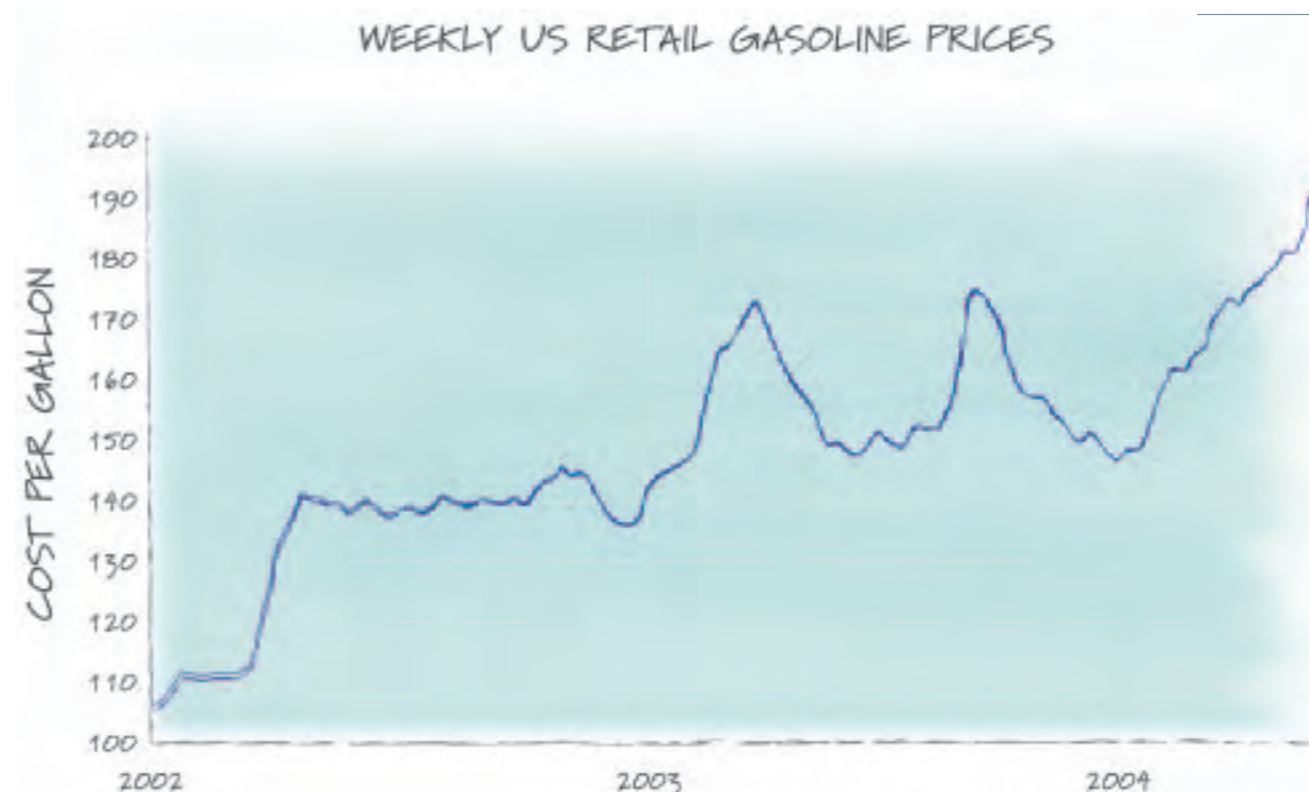
- Largest global independent automotive transmission manufacturer confirmed as our partner in development of IVT.
- Transmission manufacturers active in promoting IVT for their commercial gain.
- Broadening of market and product portfolio provides a faster route to market: off-highway customer has confirmed target for IVT production in 2005.
- Cash burn in line with expectations: strong financial position.

"We have achieved our aim of endorsement of our technology at the highest decision making levels in the automotive industry. We are now firmly in the joint planning phase of the car companies and their suppliers, the transmission manufacturers.

In parallel with this we have developed our technology to target the agricultural and construction equipment industry to broaden Torotrak's product portfolio. Pending successful prototype testing we expect IVT equipped vehicles to be in series production next year."



Latest compact IVT design, more details on inside back cover.



Source: Energy Information Administration

chairman's statement

Over the last financial year, we have achieved our goal of endorsement of our Infinitely Variable Transmission (IVT) technology at the highest decision making levels in the automotive industry.

The board has been further strengthened by the appointment of two new non-executive directors from 1 November 2003 - Dr Nick Barter and Mr David MacKay. These appointments complement the executive changes reported in 2003.

Both Nick and David bring relevant strategic skills and experience which have already contributed strongly to our transition from technical development to market exploitation. Their in-depth interrogation of the business plan has confirmed that our strategy and technical approach are correct. Through Nick's experience of leading the engineering team at Ford's Premier Automotive Group in the UK, he has endorsed the emphasis we have placed on relationship management with the key decision makers in the car industry to develop their confidence in our IVT technology. David, formerly Executive Vice President and General Counsel for ARM Holdings plc, has very recent experience in managing the licensing of world-leading technology. With this experience, he has supported the executive team in the strengthening of an already sound intellectual property model to maximise returns on the licensing of our portfolio.

During the year David Burnicle, Malcolm Coster and Ian Macpherson stood down as non-executive directors, having contributed to Torotrak's technical and strategic development as members of the board since flotation in 1998. Ian continues to advise us in a consultative capacity, testing our engineers with his inventive experience of powertrain engineering whilst researching opportunities beyond the first production

applications of the IVT to maximise Torotrak's relevance to new, emerging technologies such as hybrids. These changes complete the reshaping of the board.

Since I reported in 2003, the strong pressures on the car companies in both Europe and the US to find ways of reducing fuel consumption have reached new heights of intensity. In Europe, ACEA, the industry forum that represents the major car, truck and bus manufacturers, had to declare to the EU Commission in early 2004 that it had failed to meet its latest milestone towards achieving its voluntary improvement target. As this commitment has at its core the high profile Kyoto protocol, designed to reduce global greenhouse gas emissions, the Commission cannot be seen to allow ACEA to relax this commitment.

Until early 2004, when the full year 2002 fuel consumption results were reported, ACEA had achieved year on year improvement of their fleet average consumption. This was the result of the sale of more small cars and diesels as well as the introduction of incremental fuel saving engineering improvements. It is now recognised by both the EU Commission and ACEA that the only solution is to introduce significant fuel saving technology to meet the target. For the car companies, this means technology that will deliver double-digit percentage fuel savings across their whole product range while maintaining economic viability.

In the USA, there are identical pressures on the car companies but driven by different needs. At the beginning of the Iraq war the price of petrol went above the \$2 per gallon threshold in many states. What was seen at first as a temporary rise has continued for well over a year and shows no sign of returning to earlier levels. With the prospect of this consolidating in the

long term, fuel consumption has become the purchase discriminator the car companies feared in their push to sell cars, light trucks and sport utility vehicles. Trading down to smaller vehicles is not an alternative for their customers who are used to large vehicles with powerful engines. The car manufacturers in Detroit have had to respond by moving fuel consumption improvement towards the top of their planning agendas. These manufacturers now view transmission technology in general as the most commercially viable way of achieving this fuel consumption improvement without product compromise. Torotrak's IVT is seen by them as a transmission technology that can deliver this improvement, with new and highly marketable features and without compromise.

The growing relevance of Torotrak's technology to the major car companies has enabled us to develop further the relationships with the executives who are responsible for planning and delivering these solutions. The public endorsement of the IVT signals that the transmission manufacturers and their car company customers now regard our IVT as a robust technical, and commercially attractive, solution.

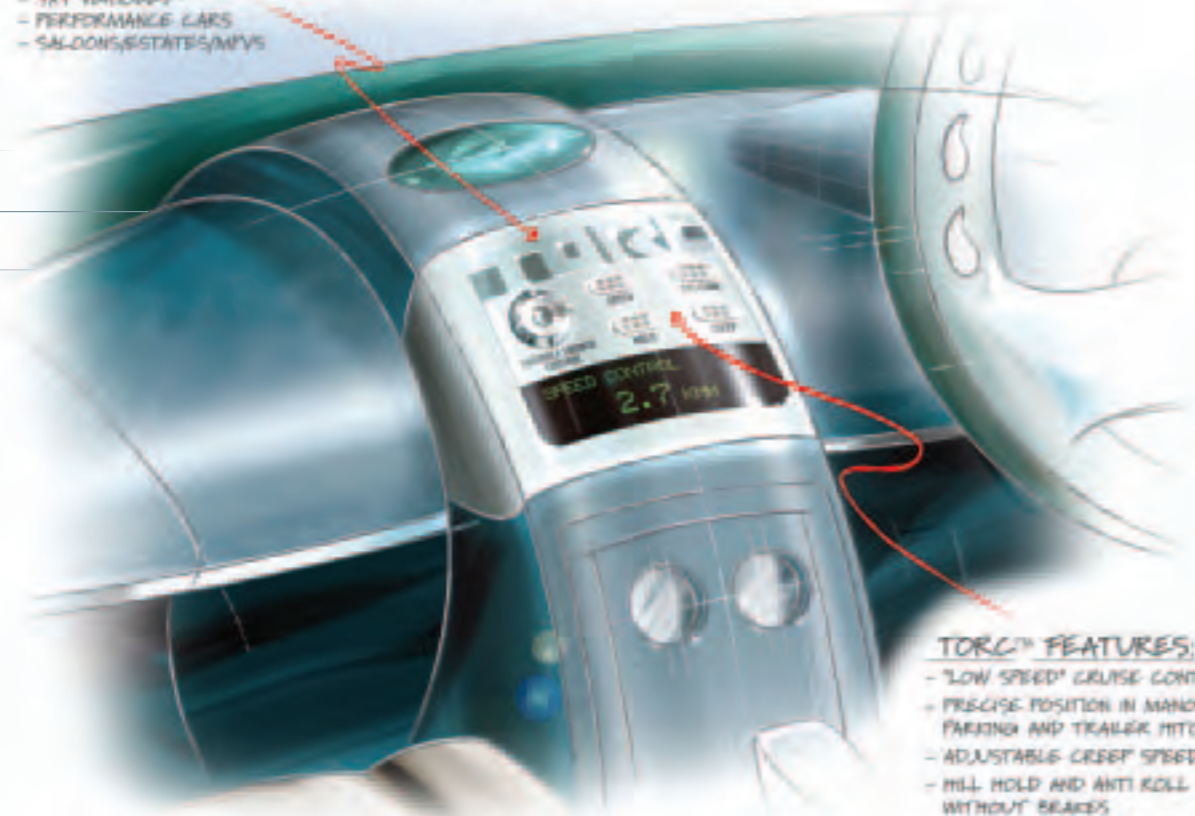
From this strong automotive base Torotrak has also begun to broaden its market and product portfolio. The development of the off-highway sector as a target market for our variable drive technology has strengthened our business plan. I am very encouraged to see the signs of tangible production commitment emerging from this work.

The last year has seen Torotrak grow in stature and credibility amongst these key customers. Our technology is now accepted as a key item on their common planning agendas.

David Wallis
Chairman
24 May 2004

FEATURES OPTIMISED INDIVIDUALLY FOR:

- 4X4 VEHICLES
- PERFORMANCE CARS
- SALOONS, STATES AND VANS

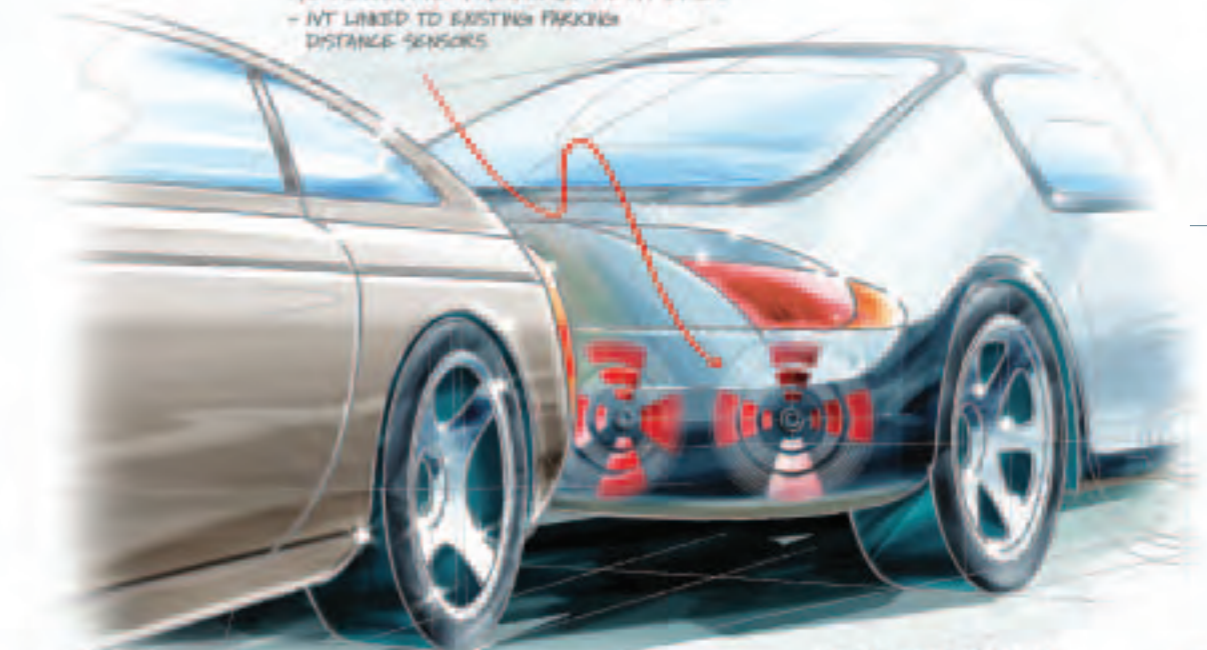


TORC™ FEATURES:

- 'LOW SPEED' CRUISE CONTROL
- PRECISE POSITION IN MANOEVRES, PARKING AND TRAILER FITTING
- ADJUSTABLE CREEP SPEED
- HILL HOLD AND ANTI ROLL BACK - WITHOUT BRAKES
- ADJUSTABLE LAUNCH CONTROL

AUTOMATIC PARKING FEATURE:

- IVT LINKED TO EXISTING PARKING DISTANCE SENSORS



chief executive's review

Torotrak's principal route to market for our infinitely variable transmission (IVT) technology continues to be via the world's automotive transmission makers and their customers, the major international car companies. As they move closer to the point of production commitment we are bound increasingly by their requirement for high levels of confidentiality across all aspects of our business. Against this backdrop, I am delighted to be able to disclose more information about the further progress we have made with our compact design following the reveal of a model of this transmission at the Tokyo Motor Show in October 2003.

This recent progress has resulted from work that has taken place between Torotrak, Koyo, our licensee and key partner on materials technology, and Equos, the new-product development subsidiary of the world's largest independent manufacturer of automatic transmissions. The fact that I can report the involvement of Equos to you is a clear indication of the high level of endorsement that Torotrak's technology now receives from the global automotive transmission community.

The constant demand from the world's car-makers for new technology, which provides clear customer benefits whilst being smaller, lighter and cheaper, has driven our joint project objectives with Equos and Koyo. This has resulted in a transmission which is 10% smaller in size than the model showcased at the Tokyo show. These improvements have been incorporated into the programme with Equos and I can confirm that prototype transmissions of this latest design will be on test rigs and installed in target test vehicles by the end of 2004.

The visibility in the automotive industry of this programme with Equos and Koyo reflects the increasing public endorsement of our IVT technology which has characterised this past financial year. These endorsements are clear signs that our transmission supplier licensees are active in promoting the IVT for their

commercial gain. Their growing confidence has allowed them to include our technology in their business planning processes and in their presentations to their car company customers. For Torotrak, this represents the 'push' side of our 'push-pull' strategy in our route to the automotive market.

On the 'pull' side, we have also seen tangible progress. Torotrak's strategy to build strong relationships with the world's leading car companies, as well as with their transmission suppliers, is paying off. An example of this is the new partnership we reported in November 2003 between one of our existing transmission manufacturing customers and a major car company. Their common interest in IVT technology forged this link, which resulted in a request for us to support their joint, aggressively timed, technical evaluation. This resulting three-way programme is now well under way and is developing strongly.

I know now that our IVT technology features in top level planning reviews between the chief executives of the transmission makers and the executive decision makers in the car companies. This is best illustrated by some recent feedback I have from the head of powertrain engineering of a major European based car company following his strategic review with the chief executive of one of his transmission suppliers. In reviewing plans for the IVT, the chief executive was happy to tell his customer, "I have my best engineers working on this technology".

The significance of a comment like this reflects the level of technical capability now established within the transmission companies. To have their top people working with us on the IVT fully demonstrates the level of commitment now being applied in this product planning phase which precedes implementation into a car programme.

To get new technology into this phase, it needs to fully satisfy the stringent technical and commercial criteria that are imposed by the car companies but there is also a need for an element of excitement. I saw evidence of this in my recent meeting with the president of another of our transmission company partners where he told me about his business review with one of his customers, the vice president of a global car company. It was clear that they both shared an enthusiasm for the unique attributes of the technology as they discussed its implementation.

These high level discussions reflect our target to bring these key decision makers together with the IVT on their agenda. Discussions have reached the point where the transmission manufacturers and the car companies are largely in self-sustained dialogue and now view Torotrak as a trusted partner to be brokering the technology between them. It is now for the car companies, with their chosen supplier, to agree and decide how the technology is integrated into their product plans.

At this stage, the work of Torotrak's engineers is to assist in the design of components and transmissions and undertake tests of these to our customers' unique requirements. This is tangible evidence of the value of our engineering know-how and is now providing Torotrak with a consultancy revenue stream which is predicted to increase as we move towards production commitments.

TORC™

Much of the enthusiasm for IVT technology has been fuelled through our latest release of Total Off-Road Control (TORC™). The car companies view this development as a 'game changing' technology in the automotive industry. During the last year, we have added to this set of IVT control features and further developed the driver interface. TORC™ is now operated from a

new control panel in the vehicle. We have been presenting this new set of controls to our customers and, as we expected, they recognise the marketable value this brings to them. The key features of these new controls are:

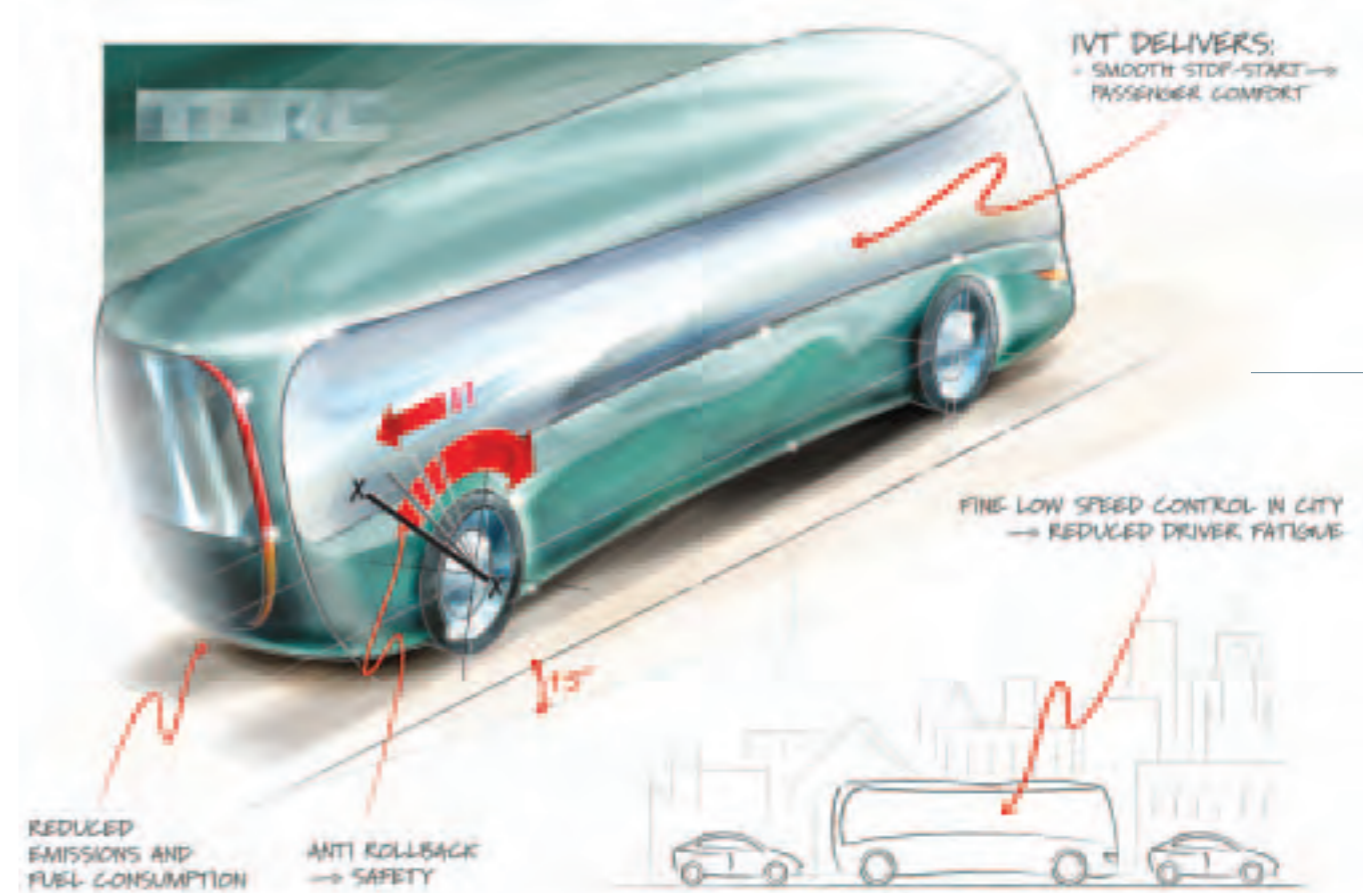
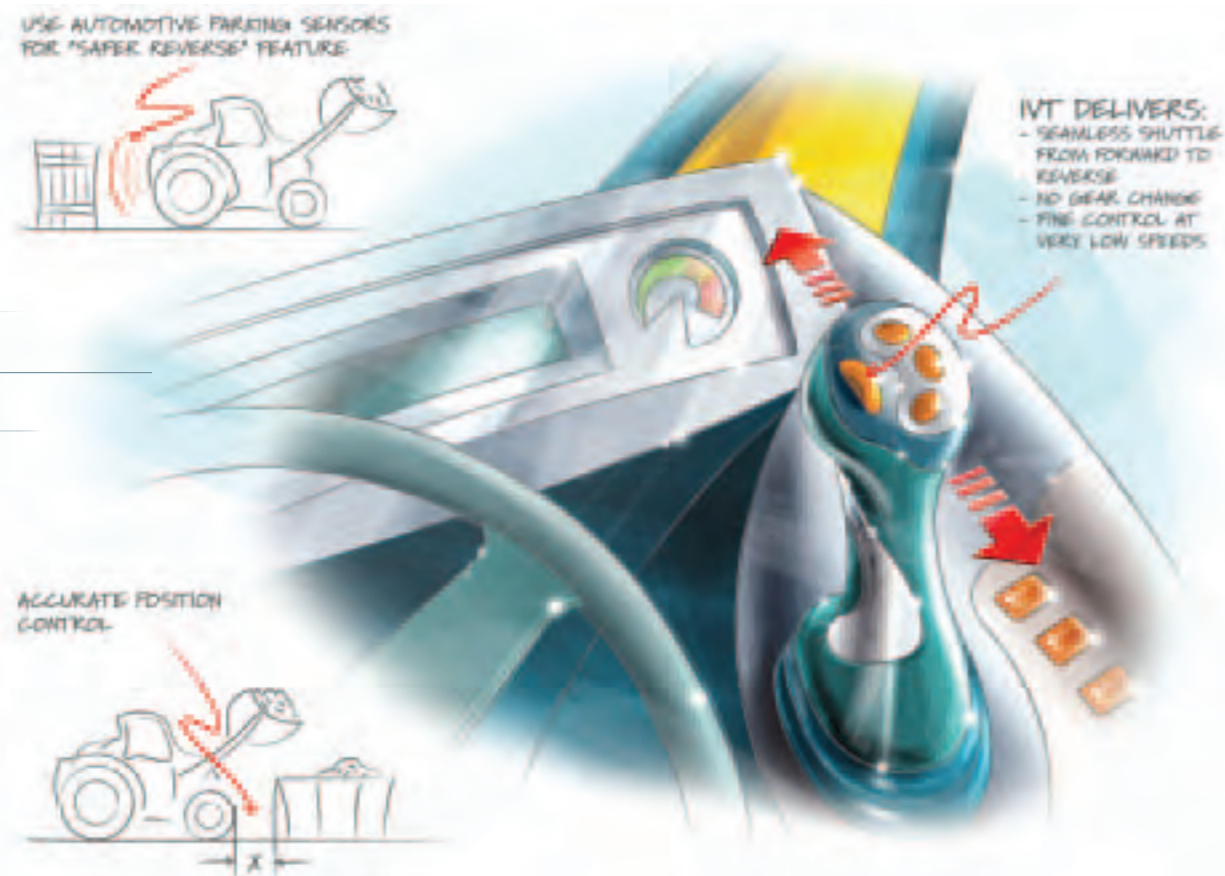
- Speed control
- Position control
- Creep control
- Hill hold
- Anti roll back

As an example, we can use the position control of TORC™ to create a parking aid where, linked to the IVT, existing front and rear parking sensors would allow the TORC™ equipped vehicle to centre itself automatically between two parked vehicles.

Whether the car company's application is a 4x4, a sports car or a saloon, TORC™ has something to offer. Getting senior car industry executives to experience TORC™ first hand in a vehicle demonstration has yet to fail to elicit a broad grin. Comments from them such as "I didn't think a transmission could do that" confirm the value that this latest development is delivering for Torotrak.

Off-Highway

The recent developments in TORC™ are very closely aligned to the attributes that are demanded from an off-highway transmission. We have used this to gain more momentum in the off-highway, truck and bus sectors as a way of broadening our market and product portfolio.



chief executive's review

The off-highway sectors - the agriculture and construction equipment industries - are already familiar and experienced with the key characteristics of TORC™, such as low speed control, shuttling and hill hold.

As our automotive customers have become confident and more self-sufficient with our IVT technology, we have been able to release more engineering resources to respond to enquiries from the off-highway sector. As a result, I can report that we are now working with a number of internationally recognised companies whose products are engineered, manufactured and distributed globally. Their interest in Torotrak is founded on the principle that they have been using variable transmissions, in the form of hydrostatic drives, for many years. These drives have become that industry's standard but are constrained in their use because they are expensive and mechanically inefficient.

Torotrak's IVT technology can replace a hydrostatic drive at lower cost and with greater efficiency. The very simple transmission layouts that have resulted from our work with the engineers in this sector feature far fewer parts than is normal in this industry. This enables the unit cost of their transmission solutions to be driven down significantly.

The market for off-highway vehicles is tough and highly competitive and, like the automotive industry, technology and innovative features are a strong source of advantage. The recent developments of TORC™, which are software based, have generated an exciting range of driver features and benefits which are very relevant to the off-highway sector. The inherent ability of IVT to enable a vehicle to shuttle from forwards to reverse in one seamless action and allow control of the vehicle from normal road speed right down to an accurate centimetre-by-centimetre crawl is viewed by this industry as highly

marketable. This transmission capability can be presented to the end-customer in many innovative ways, thus providing competitive edge.

Torotrak is now offering the international names in off-highway vehicle manufacture an alternative transmission technology which will provide their customers with equipment that delivers increased performance, more features and lower running costs.

Importantly for Torotrak, the product development process in the off-highway industry is shorter than is typical in the automotive sector. This means that prototype-to-market launch can be as short as two years.

One of our off-highway customers is already in the product development process and is entering the prototype trial stage. Pending successful validation testing by this customer, they have targeted their new IVT equipped vehicle for initial series production in 2005.

Although, in general, the production volumes in the off-highway sector are lower than in automotive, this development represents an excellent opportunity for Torotrak to support our mid-term business outlook with a production royalty stream en-route to our high volume automotive applications.

Trucks

The truck industry is not immune to the relentless pressure for emissions and fuel economy improvements as seen in the car industry. Truck manufacturers are now facing the challenge to deliver unprecedented levels of technological change. As an example, in the USA, the Environmental Protection Agency (EPA) has formulated a comprehensive national emissions control programme to regulate highway heavy-duty vehicles.

This is forcing through tough new emissions standards for trucks with effective dates of 2007 and 2010. This two-stage emissions programme requires that the level of emissions drop to one-twelfth of the current levels. Such a goal is beyond the reach of minor engineering changes.

The practical constraints of the truck industry mean that the use of aerodynamics and lightweight construction is unrealistic. It is clear from our discussions that their only realistic choice is to develop new engine and transmission technologies. One leading US truck transmission manufacturer who has approached us has already concluded that a variable drive transmission is required to meet this legislation and recognises that the high torque capacity and scalability of Torotrak's IVT technology make it well suited to this new technical challenge. As a result, our engineers are currently undertaking modelling and simulation work with this transmission manufacturer to confirm the suitability of our technology for their products.

Buses

There is also intense pressure on the bus industry in Europe to make a significant improvement in fuel economy, particularly for urban use. The bus manufacturers are in real need of practical solutions which stand the long-term test of commercial viability. This has led to a number of discussions with manufacturers around additional applications for our IVT. The duty cycle of buses is often particularly demanding with a high content of stop-start driving. Under these arduous conditions, the absence of a starting clutch or torque converter in our IVT is recognised as a key strength. One European based manufacturer who has approached us directly has seen this strength as bringing them a competitive advantage from fuel economy and smoothness of ride. As a result, together we are developing a detailed plan to demonstrate this advantage to

their customers, the main fleet operators. The IVT provides them with a practical and commercially viable solution without the constraints of more radical technologies such as hydrogen fuel or battery propulsion.

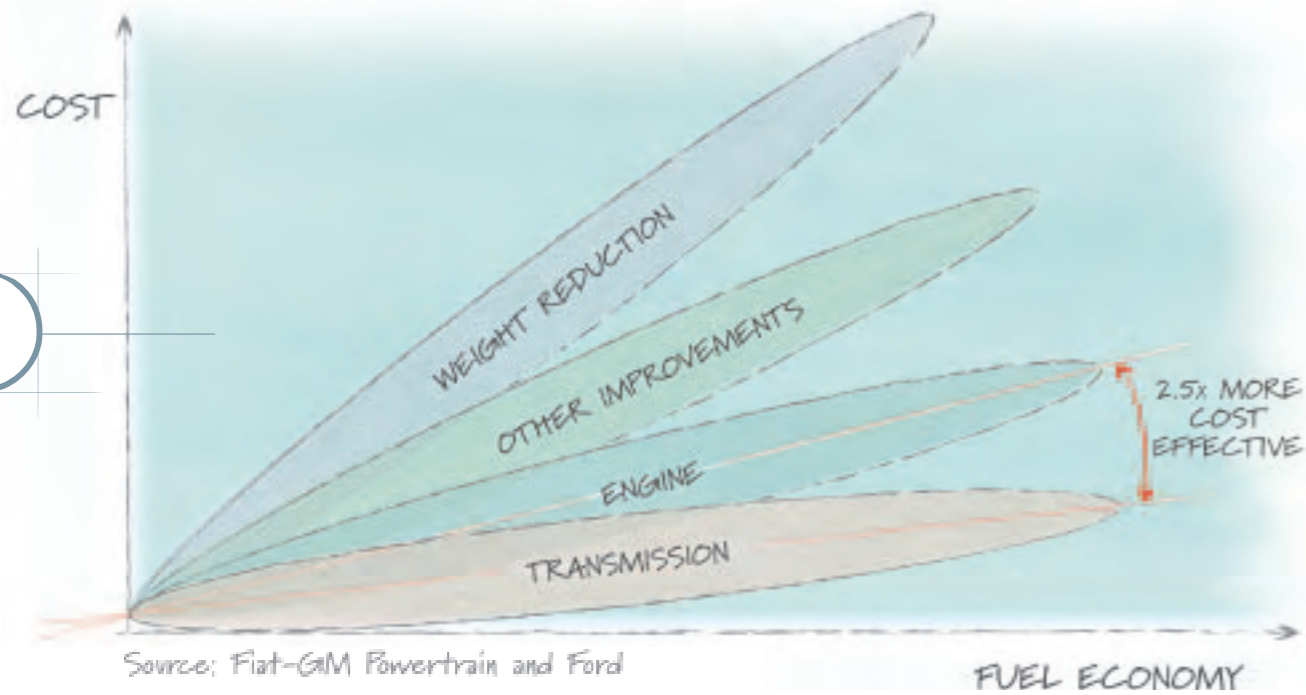
Competition

Torotrak's competition remains those other technologies that can also deliver a significant change in fuel economy. These include lightweight vehicles, improved aerodynamics and advanced engine technologies. In the last year, the automotive industry has concluded that transmission technology will deliver the biggest contribution per unit cost (at least 2.5 times more cost-effective than any of these alternatives) towards their goal of better fuel economy with reduced emissions. Indeed, in October 2003, at a major international transmission conference co-sponsored by Torotrak, this topic was a central theme and in one of the keynote speeches a senior executive from the industry declared, "this is the decade for transmission technology".

Already we have seen an acceleration of this new product activity in the world of transmission engineering. In the space of only two years, the 6-speed fixed ratio automatic (6AT) has moved from being a premium transmission to being a commodity within the industry. This is a well-trodden path which we expect the IVT to follow. The car industry is now looking for the next transmission technology beyond the 6AT; one of the global car companies we are working with has told us that they now hold the clear view that variable drive technology is the logical successor to their fixed ratio automatics.

Variable drive technologies currently in the market are the belt and chain drive Continuously Variable Transmissions (CVTs) and the half-toroidal traction drive CVT. The belt and chain CVTs are

THE COST OF FUEL ECONOMY IMPROVEMENTS



chief executive's review

torque and power limited and therefore have a restricted application. In contrast, our IVT is not constrained by these limitations. The half-toroidal CVT, which is available in the marketplace only in Japan, does not provide a significant fuel economy benefit beyond the 6AT and as a result is produced in very low volumes. The IVT, however, continues to prove that it consistently delivers double-digit percentage fuel economy improvement.

Hybrid electric vehicles

In the automotive industry, over the last six months, there has been a significant amount of high profile activity with regard to hybrid electric vehicles. Electrical hybrids are seen to be a big potential contributor to lower emissions and to fuel economy. They operate by using a combination of two types of motive power: an internal combustion engine and a sizeable electric motor and generator. The main purpose of the electric generator is to recover the kinetic energy otherwise lost through vehicle braking as heat (regenerative braking) and to store it electrically. The electric motor then uses this stored power to help to accelerate and drive the vehicle.

There are two main types of hybrid emerging from the research activities of the car companies.

The first is the complex split-hybrid which uses a large electric motor and a power-split transmission in place of a conventional gearbox. This configuration requires a radical change to the layout of the vehicle. Although vehicles of this type are already in the market, the technology has not been accepted by many car manufacturers due to the high additional investment and unit costs involved. The main benefit of this type of complex hybrid is that in addition to the regenerative mode it allows the engine to run under optimum conditions with consequent improvements in fuel economy and emissions.

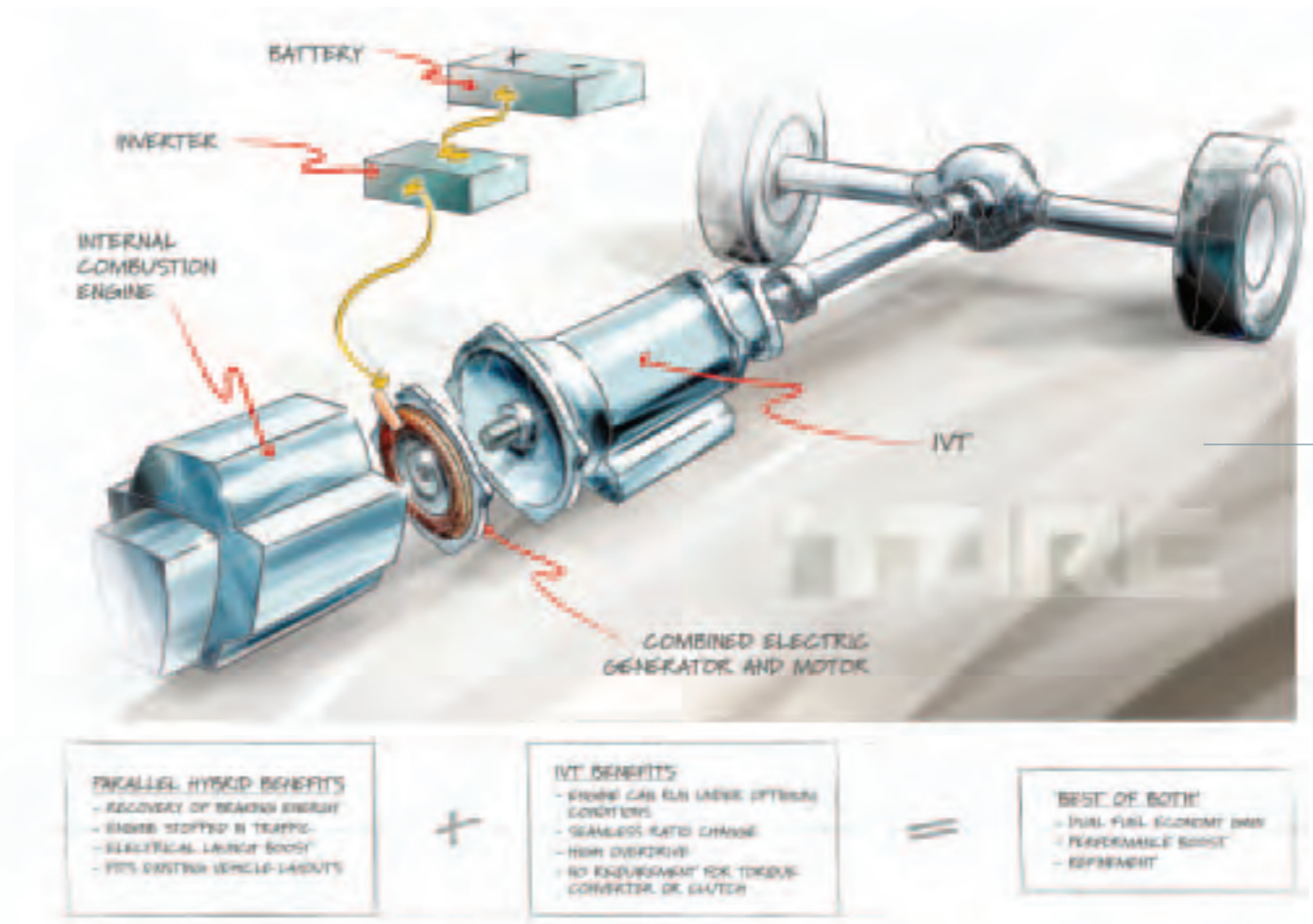
The second form of electrical hybrid, known as a parallel-hybrid, offers the benefits of regenerative braking but in combination with a conventional fixed ratio transmission. This parallel-hybrid arrangement is well suited to existing vehicle layouts and is already on sale in several vehicles in North America. From the number of engineering programmes that have been started across the automotive industry, it is evident that parallel technology is emerging as the preferred hybrid configuration for high volume application.

A limitation of currently available parallel-hybrids, however, is that they do not allow the engine to run at optimum conditions. This limits the degree of fuel economy advantage that can be achieved. The application of our IVT technology to parallel-hybrids allows for this limitation to be overcome.

At the heart of the technological advantage of our IVT is its inherent ability to allow the engine to run under optimum conditions. This advantage, when applied to a parallel-hybrid, allows car companies to provide the principal benefits of complex split-hybrid configuration but within a conventional vehicle layout.

The growth of hybrid electric vehicles in the global car market over the next 15-20 years is inevitable. Industry forecasts show only a very small penetration of hybrid vehicles by 2010. Industry observers expect that virtually all passenger cars in production in 2020 will still be powered by an internal combustion engine, but with up to 50% of these including some form of regenerative capability. The principle of recovering the energy that would otherwise be lost by braking is now widely accepted in the industry as a logical step for greater fuel economy.

Torotrak has been working with two industry partners to quantify accurately the extent to which our IVT technology can



further improve fuel economy and performance gains when integrated into parallel-hybrid configurations. With this knowledge, we will be able to position ourselves as the transmission technology of choice for high volume, parallel-hybrid vehicles as this market develops.

Outlook

The automotive industry remains Torotrak's key target for long-term shareholder value. In the last year, we have crossed a crucial threshold in our route to success in the automotive market. The car companies and their transmission suppliers are now largely in self-sustaining discussions over their plans to implement the IVT. Torotrak will continue to support them as they develop these plans and progress through their delivery and launch programmes. As they do so, our objective is to market our respected engineering skills to them to earn increasing levels of consultancy revenue.

In parallel we will use the development of TORC™ features to gain more momentum in the off-highway, truck and bus sectors. This broadening of our market and product portfolio provides us with an additional and faster route to market. We will seek to exploit this for both short- and medium-term revenue streams.

We will commit more of our engineering resources into researching and inventing future generations of IVT technology, developing new concepts to reinforce IVT's long-term commercial value to our customers. An example of this that we can already see is our increased work with emerging electric hybrid technologies to position the IVT as the transmission technology of choice as this new market develops.

Dick Elsy
Chief executive
24 May 2004

finance director's review

Revenue

Torotrak earns revenue from two sources:

First, licence income which takes the form of stage payments as well as royalties. We receive stage payments in the form of a series of downpayments from each licensee during their evaluation and development of the IVT technology before production starts. Stage payments vary considerably in amount and timing and, as in previous years, revenue in this financial year includes a small licence downpayment. We will earn royalties when production actually starts and these are payable on each transmission produced by our licensees. We are encouraged by confirmation from a global transmissions manufacturer that our proposed royalty rates are fair and reasonable.

Our second source of income is contract income. As expected, our contract income revenue has started to increase over the last year as the focus of the business has moved from technical development to marketing and commercialisation. This has meant that more of our engineers' time and skills can be used to support our licensees and customers in their development work. This is where our engineers can generate revenue for our contribution to the integration of the IVT into vehicles. Our objective is for this type of revenue to increase over the next few years as we become more involved in the vehicle programmes which will feature our IVT technology.

Operating expenses

We have a strong culture within the business of very tight cost management. The planned increase in emphasis on marketing and business development has resulted in a controlled rise in costs in these areas but overall administration costs have reduced by £50k.

Development expenses of £5,758k (2003: £5,205k) consist primarily of the cost of technical staff, hardware for technology development and the protection of our intellectual property. All of the new prototype transmissions being developed now are being sourced and paid for by our licensees. Internally, our development activity has increased, with work on refinements such as TORC™ and the continual work on new compact lightweight designs. An example of this is the compact lever arrangement. This innovative arrangement to control the movement of rollers in the IVT has been the means by which we have achieved the major improvements in transmission size. This patented technical breakthrough has enabled us to match the world's most compact 6-speed automatics in size and weight.

These developments allow us to add continually to our patent portfolio. Since last year we have filed 18 new patents and made a further 11 inventions that are waiting to be patented.

This continual innovation benefits us in two ways:

- First, by underpinning our long-term royalty income. By offering the car companies and transmission manufacturers this continuous stream of innovation we demonstrate the value to them of our long-term commitment to the development of the technology.
- Second, by extending our revenue earning life because our licences last as long as the longest patent. As of now, our revenue earning life extends to 2024.

Loss and taxation

Interest receipts of £522k (2003: £764k) continue to be affected by the low level of interest rates in the UK.

Research and Development tax credit of £0.9m has been credited in respect of the 2003/4 financial year (2002/3: £0.8m). The claims for 2001/2 and 2002/3 were agreed by and received from the Inland Revenue during the financial year.

The loss before tax of £7.0m (2003: £6.4m) led to a loss per share of 5.36p (2003: 4.88p), in line with expectations.

Capital expenditure and fixed assets

Capital expenditure remains at a low level following completion of the programme in 2001 resulting in expenditure of £0.1m (2003: £0.2m).

Cash flow and treasury

The cash outflow (movement in net funds) for the year of £4.6m compares to £4.4m in 2003.

At 31 March our cash resources were £11.8m, which, together with other sources of cash, including the tax credits above and increasing revenue from our customers, and leaves us well resourced.

We continue to maintain strong internal control over our cash balances with regular reporting of balances and cash flow forecasts. Our investment policy remains conservative with the objective of optimising interest receipts whilst minimising risk and maintaining flexibility. Balances at the year end are invested in money market managed funds.

Currently, the group has no significant transactions in foreign currency. Exposure to foreign exchange rate risks therefore remains minimal.



Rebecca Joyce
Finance director
20 May 2004

corporate responsibility

Whilst we are accountable to our shareholders, we take into account the interests of all our stakeholders including our employees, our suppliers as well as the local community and the environment in which we operate.

Employees

As an intellectual property group we are more reliant than most on the creativity, drive and goodwill of our employees. Culture and values are at the heart of our business plan and we seek to establish a partnership, consulting with and involving all levels of employee, valuing their ideas and suggestions. Regular team briefing sessions and a consultation committee combined with a comprehensive suggestion scheme, personal development plans and the performance assessment system encourage open channels of communication.

Employee share ownership is actively encouraged and the group has established five schemes to incentivise, reward and motivate all employees, details of which are given on the directors' report on pages 18 and 19.

The group has a strong demand for highly qualified staff and, as such, we strive for equal opportunity and a non-discriminatory work environment for all present and future employees. Disability is not seen to be an inhibitor to employment or career development within the group.

We provide clean, healthy and safe working conditions. As a group, we pride ourselves on providing our employees with a very attractive working environment. We encourage proactive participation by all our employees in identifying and controlling hazards. The health and safety performance is monitored by the board and we are pleased to report that we had no RIDDOR reportable accidents during the year.

Community involvement

In January this year, Torotrak hosted a second roadshow for school children from all over Lancashire aimed at promoting science, technology, engineering and mathematics. The one-day event, organised with SETNET Lancashire (part of the Science Engineering Technology Mathematics Network), is a government initiative about ensuring that there is a flow of well motivated, high quality young people in schools who have an interest in, and an understanding of, engineering related subjects.

During the year Torotrak also became a corporate member of the Engineering and Technology Board (etb), the organisation spearheading ambitious initiatives to open hearts and minds to science, engineering and technology in the 21st century. Torotrak, SETNET and the etb are working together to encourage more young people to choose a career in science and engineering.

Torotrak is also involved in a number of charitable causes and the staff consultation committee has authority to donate sums of money at their discretion from an amount set aside by the group. In addition, employees are involved in a number of fund raising activities. Charitable donations by the group during the year amounted to £1,000 (2003: £1,000). No political donations were made (2003: nil). The group and the employees were pleased to support the following local and national charities during the year: Derian House Children's Hospice, Chorley; The Multiple Sclerosis Society, Leyland; Oxfam and Guide Dogs for the Blind.

Environment

Torotrak is an intellectual property group. Our principal end products are patents, design rules, models, know-how and the transfer of our knowledge to our licensees.

Our premises are composed entirely of offices and test facilities since we have no manufacturing capability. 'Resources' principally comprise employees and equipment, while 'production processes' are largely cerebral involving the skill, knowledge and ingenuity of our employees. They do not involve any hazardous substances or complex waste. Our operations are therefore 'low impact' in environmental terms.

Our activities are focused on the development of the Torotrak IVT, which offers very significant improvements in fuel economy and emissions. The IVT is principally aimed at passenger cars, one of the world's major sources of environmental concern.

Our environmental policy is published on our website. The group does not encourage the provision of company cars, which number only two. The provision of cycle sheds, showers and changing facilities encourages greener commuting and telephone and video conferencing are used extensively, providing alternatives to international travel. Wherever possible the group continues to adopt initiatives to lessen our environmental impact even further.

directors, secretary and advisors



David Wallis
Non-executive chairman and chairman of the nomination committee, aged 66. 1, 2, 3

Following nearly 40 years of experience in the automotive industry with GM, David Wallis joined Torotrak in 1997. Until recently, he was the executive director of the Low Carbon Vehicle Partnership (Low CVP). Low CVP is a new government sponsored action and advisory group, formed by the Energy Savings Trust, to help maximise the potential competitive advantage for UK business from the shift to clean low carbon vehicle technology and fuels in the UK. He is also chairman of the Consultancy Business Limited.



Dick Elsy
Chief executive, aged 44.

Dick Elsy joined Torotrak as chief executive in January 2003. He was most recently Product Development Director at Jaguar Cars Limited (part of Ford Motor Company). He previously spent 16 years at BMW AG/Rover Group where he held various senior engineering and commercial positions. In 1998 he won an award from the Royal Academy of Engineering for outstanding contribution to British engineering. He is a Chartered Engineer and a Fellow of the Institution of Mechanical Engineers.



Rebecca Joyce
Finance director, aged 43.

Rebecca Joyce joined Torotrak in 1997 having spent 12 years at Touche Ross and Grant Thornton where she became a partner in 1994. She joined Torotrak from L. Gardner Group plc, an engineering group in the automotive and aerospace sectors, where she was group company secretary. She is a Fellow of the Chartered Association of Certified Accountants.



John Grant
Non-executive director, chairman of the audit committee and the senior independent non-executive director, aged 58. 1, 2, 3

John Grant was appointed as a director of Torotrak in 1998. He is chairman of two specialist engineering companies, Hasgo Group Limited and Peter Stubs Limited, and of the Royal Automobile Club Motor Sports Association Limited (the UK governing body for motor sport). He was chief executive of Ascot plc from 1997 to 2000 and finance director of Lucas Industries plc (subsequently Lucas Varity plc) from 1992 to 1996. He previously spent 25 years at Ford up to 1992, where he was vice-president, Ford of Europe; director of corporate strategy, Ford US and executive deputy chairman of Jaguar. He is also a non-executive director of National Grid Group plc, Corac Group plc, Cordex plc and the Royal Automobile Club Limited.



Nick Barter
Non-executive director, chairman of the remuneration committee, aged 63. 1, 2, 3

Nick Barter was appointed as a director of Torotrak in November 2003, having retired from Ford Motor Company in 2002 after 22 years. He was most recently Director of Product Development for Jaguar and Land Rover, part of Ford's Premier Automotive Group. He was responsible for all aspects of planning, design, development, sign off and introduction of all Jaguar and Land Rover vehicles, leading a team of around 5,000 engineers, designers and analysts.

Following his retirement from Ford, he was appointed Programme Director of the government funded automotive research programme, Foresight Vehicle, where he is now responsible for sponsoring cutting-edge technologies focused on developing more fuel efficient vehicles.



David MacKay
Non-executive director, chairman of the intellectual property committee, aged 47. 1, 2, 4

David MacKay was appointed as a director of Torotrak in November 2003. He was formerly Executive Vice President and General Counsel for ARM Holdings plc, one of the most successful UK technology companies, whose core business is founded upon the design and licensing of world-leading technology. His principal responsibilities there included negotiating and drafting technology-related agreements including intellectual property licences, international manufacturing and distribution agreements and joint venture agreements.



David Price
Chief technical officer, aged 49.

David Price joined Torotrak as product engineering director in 1998 and was appointed to the board as chief technical officer in 2002. He joined Torotrak from Prodrive, the motorsport and automotive engineering consultancy, where he was general manager of the Engineering Division having previously spent 18 years at Ford in Truck Transmission Engineering and Powertrain Research. He is a Member of the Institution of Mechanical Engineers and the Institute of Directors.



James Batchelor
Commercial director, aged 48.

James Batchelor joined Torotrak in March 2003. He was most recently commercial director of Trafficmaster Automotive, the telematics and traffic information group. He spent six years at BMW AG, latterly as project director for Land Rover having previously spent 13 years at Rover Group. He has an MBA from Cranfield School of Management and is a Chartered Engineer and a Fellow of the Institution of Mechanical Engineers.

- 1 Member of the remuneration committee
- 2 Member of the audit committee
- 3 Member of the nomination committee
- 4 Member of the intellectual property committee

Company secretary
Rebecca Joyce FCCA

Stockbrokers
Evolution Beeson Gregory,
100 Wood Street,
London EC2V 7AN

Registrar
Capita Registrars,
Northern House, Woodsome Park,
Fenay Bridge, Huddersfield HD8 0LA

Auditors
KPMG Audit Plc, Edward VII Quay,
Navigation Way, Ashton-on-Ribble,
Preston PR2 2YF

Bankers
Barclays Bank plc, 54 Lombard Street,
London EC3V 9EX

Solicitors
Hammonds, 2 Park Lane,
Leeds LS3 1ES

Registered office
1 Aston Way, Leyland
Lancashire PR26 7UX

Registered number
3580465

directors' report

The directors present their report on the results and affairs of the group for the year ended 31 March 2004.

Business activity

The Torotrak group is the world leader in the design and development of traction drive infinitely variable transmission (IVT) systems. Our technology offers the automotive industry significant improvements in fuel economy, performance and smoothness combined with innovative driving control features. Torotrak's principal commercial strategy is to generate royalty income from volume manufacture of its IVT by car companies and transmission suppliers.

Operating and financial reviews

The business is reviewed in the chairman's statement on page 2, chief executive's review on pages 4 to 9 and the finance director's review on page 10. Information on likely future developments in the business is included in these reviews.

Dividend

The directors do not recommend the payment of a dividend.

Directors

The directors who held office during the year are set out below:

David Wallis
Richard Elsy
Rebecca Joyce
David Price
James Batchelor
John Grant
Malcolm Coster (resigned 31 October 2003)
Ian Macpherson (resigned 31 December 2003)
David Burnicle (resigned 31 October 2003)
Nicolas Barter (appointed 1 November 2003)
David MacKay (appointed 1 November 2003)

Biographical details of the directors in office at the year end are shown on pages 12 and 13.

Directors' remuneration, service contracts and shareholdings

Information on directors' remuneration, contracts and beneficial interests in the shares of the company are included in the remuneration report on pages 21 to 24.

Election of directors

Nicolas (Nick) Barter, non-executive director, and David MacKay, non-executive director, who were appointed to the board during the year offer themselves for election at the annual general meeting. Rebecca Joyce, finance director, and John Grant, non-executive director, retire by rotation and offer themselves for re-election. Their biographies are shown on pages 12 and 13.

Corporate governance

The board is committed to the highest standards of corporate governance. All of the directors are equally responsible to shareholders for the management of the group and the protection of its assets. As such, the board is ultimately responsible for ensuring that the group maintains adequate systems of internal control and reviewing its effectiveness. The internal control systems are designed to meet the group's particular needs and the risks to which it is exposed. The systems are designed to manage rather than eliminate risk and can only provide reasonable but not absolute assurance against material mis-statement or loss.

Combined Code

The company complies, and complied throughout the year ended 31 March 2004, with the relevant provisions of the Combined Code, including the recommendations of 'Internal Control: Guidance for Directors on the Combined Code' (the Turnbull guidance).

The board

The board currently consists of the non-executive chairman, four executive directors and three other independent non-executive directors. Brief biographies of each of the directors appear on pages 12 and 13.

Following the departure of the previous chief executive, David Wallis combined the role of non-executive chairman with that of acting chief executive for four months from September 2002 to January 2003 when he stepped back to his role as non-executive chairman. This meant that the company did not comply with the code in this respect in the previous year. The board is satisfied that this short-period as an executive director has not affected Mr Wallis's independence and accordingly considers him to be independent.

John Grant and Nick Barter both have many years of experience at senior levels at Ford, one of our licensees. The board considers that the knowledge and expertise of general automotive practice and car manufacturer practice in particular continues to be of great importance to the group at this stage. Mr Grant has not been employed by Ford for over 10 years. Dr Barter left Ford in 2002, and prior to becoming a non-executive director of Torotrak, had no dealings with the group. Accordingly the board considers them both to be independent. Mr Grant is the board's senior independent non-executive director.

The board structure creates a balance of power such that no individual or small group of individuals can dominate the board's decisions. The company does not combine the role of chairman and chief executive. The chairman is responsible for the running of the board, and the non-executive directors have particular responsibility to ensure that the strategies proposed by the executive directors are fully discussed and critically examined. The chief executive's responsibilities focus on managing the group and implementing board strategy and policy.

The company secretary is responsible for ensuring that board procedures are followed and all directors have access to her advice. The board met 12 times during the year and is supplied in a timely manner with information to enable it to discharge its duties. The board has a schedule of matters reserved for its approval including, for example, major capital expenditure and patent abandonment.

The directors are entitled to take independent professional advice and receive appropriate training in the course of their duties, at the company's expense. During the course of the year a number of directors received training on the role and duties of a director of a public company, corporate governance and the Combined Code.

Board committees

The board has delegated specific responsibilities to four committees. Each committee is chaired by a non-executive director and operates within defined terms of reference set by the board.

Audit committee - Reviews and recommends approval by the board of the annual and interim results and the related Stock Exchange announcements and ensures that appropriate accounting and financial policies and controls are adhered to.

It also reviews the scope and planning of external audits, the half year and full year reports from the external auditors, their independence and objectivity including the nature and extent of the non-audit services provided by their affiliated firms and considers recommendations concerning the appointment and remuneration of the external audit firm.

The committee meets three times a year and the external auditors and the finance director attend all meetings to ensure that all of the information required by the audit committee is available to enable it to operate effectively. The external auditors have the opportunity to meet with the committee without the executive directors being present as required.

Remuneration committee - Reviews salaries, performance-related remuneration, pension arrangements and share incentive arrangements for the executive directors and directors of subsidiaries and makes recommendations to the board. The remuneration report, on pages 21 to 24, includes details of remuneration policy and procedures and on the remuneration of directors.

directors' report cont...

Nominations committee – Reviews proposals for the appointment of executive and non-executive directors or the extension of existing appointments and makes recommendations for approval by the board.

Intellectual Property committee – This committee was constituted during the year to advise and inform the board on Intellectual Property matters. It assists the executive directors with the evolution and implementation of patenting strategies and optimising protection under licensing arrangements.

Risk management

There is a continuous process for identifying, evaluating and managing the significant risks the group faces, which has been in place for the year under review and up to the date of approval of the financial statements. This process is regularly reviewed by the board and accords with the Turnbull guidance.

There is a strong control framework within which the group operates. This contains the following key elements:

- A strong control conscious culture across all areas of operation.
- An organisational structure with clearly defined lines of responsibility, delegation of authority and reporting requirements.
- Defined expenditure authorisation limits.
- Clear segregation of duties.

Major commercial, technological and financial risks are formally assessed during the annual business planning process which takes place in the last quarter of the financial year.

The board monitors exposure to key business risks and progress towards achieving strategic aims. The board reviews the annual budgets and the capital expenditure programmes of the trading subsidiaries and considers environmental, health and safety and employee issues.

There is a comprehensive system of financial reporting. The annual budget, which is derived from the business plan, is reviewed in detail and approved by the board. The finance director presents a report to the board each month detailing the results of each principal business unit, variances against budget and other performance data.

The principal system for evaluating and managing risk is the regular meeting of the executive committee. The executive committee consists of the executive directors and the senior management of subsidiaries. The purpose of the meeting is to monitor and control operations. Performance is reviewed, risks identified, financial and other implications assessed and corrective actions agreed as necessary. Each month the chief executive presents the outputs of this weekly meeting to the board who review matters arising.

Given the group's small size and the high degree of centralisation in the way the business is run, the board does not consider that it would be practicable to have its own financial internal audit function at present. Instead it has chosen to date to contract out such activities on a project by project basis. The group does however have an internal review function that carries out activities designed to improve processes within the group. These include reviewing progress on engineering projects to ensure these are carried out to the highest industry standards, establishing improved information flows, and developing better project management systems.

Key risks facing the group

Technical

Many of the risks identified at time of flotation in 1998 have been successfully eliminated. However, whilst solutions to these issues have been developed and work continues to optimise performance there can be no guarantee that further technical issues will not arise in the future.

Licence agreements

The group's long term commercial success is dependent on successfully exploiting existing and future licence agreements to generate revenue from licence fees and royalty payments. As the group does not intend to manufacture the Torotrak IVT in volume, the group is dependent on its licensees manufacturing or procuring the IVT to incorporate into their products in sufficient volume to satisfy initial demand and thereafter to attain market share successfully.

Patent protection

Our success will also depend on our continuing ability to establish, protect and enforce our proprietary rights relating to the IVT. Patents that have been granted or applied for currently expire during the period up to 2024. We also rely on know-how and software to maintain our technological lead although protection of this type of intellectual property is more difficult to enforce than patents.

Our patents or applications may become involved in opposition or revocation proceedings instituted by third parties or we may find it necessary to take action against infringers ourselves. If such proceedings were initiated the defence of our rights could involve substantial costs and cannot be predicted with certainty.

Competition

It is possible that competitors may develop more effective technologies or produce superior products. An assessment of other emerging technologies are given in the chief executive's review on pages 4 to 9.

Relations with shareholders

The company gives high priority to communications with shareholders by means of an active investor relations programme. The chief executive and finance director meet regularly with institutional shareholders and analysts and undertake a rolling programme of presentations to private investor intermediaries. All shareholders are welcomed at the company's annual general meeting, notice of which is on pages 41 and 42. In particular, the meeting provides an opportunity for private investors to meet with the board.

The company's interim and annual reports are available from the company's head office free of charge. They are also available on the company website (www.torotrak.com).

Going concern

After making enquiries, the directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing the financial statements.

directors' report cont...

Share option schemes

At 31 March 2004 the total number of shares over which options have been granted to directors and employees under all share schemes was 6,246,394, representing 5.33% of the allotted share capital of the company.

The Sharesave scheme

The Inland Revenue approved savings-related share option scheme ('the Sharesave scheme') is open to all employees, including executive directors, who enter into an approved savings contract for a period of three or five years. Inland Revenue rules limit the maximum amount that may be saved to £250 per month. Options are granted when the savings contract is commenced, to acquire the number of shares that the total savings will buy when the savings contract expires. Under current regulations tax free bonuses are paid at the end of the savings contract and, if the savings contract continues for another two years, an additional tax free bonus is paid but no shares may be purchased.

At 31 March 2004, 82 employees and former employees held options to acquire 2,932,305 shares representing 2.50% of the allotted share capital with exercise dates and prices as follows:

Grant date	Number of employees	Number of shares	Exercise date	Exercise price
Dec 1998	2	12,198	Feb 2004	£0.83
June 1999	3	30,447	Aug 2004	£0.92
Jan 2001	1	3,515	Jan 2006	£0.96
Dec 2001	1	1,938	Jan 2005	£0.98
July 2002	81	2,884,207	Sept 2005	£0.21

The share option schemes

The company operates two share option schemes, an Inland Revenue approved share option scheme ('the approved scheme') and an unapproved scheme. Except as described below the rules of both schemes are substantially the same.

The schemes are open to all employees, including executive directors. The unapproved scheme is open to both UK and non-UK resident employees and executive directors. The grant of options is at the discretion of the directors upon recommendation by the remuneration committee. The annual exercise price of shares under option granted to an individual under both schemes cannot normally exceed two times the employee's salary. The latest date for exercise of options under both schemes is ten years from the date of grant. The earliest date is dependent on achievement of the performance criteria.

The performance criteria for all grants of options prior to 2002 require that the group has:

- achieved market launch of the Torotrak IVT in series production vehicles and;
- earned £20 million in revenue.

The performance criteria for the options granted in 2002 require that the average share price over the 30 days up to the performance test date should be:

- 75p for one third of the options to vest;
- 150p for two thirds of the options to vest;
- 250p for all the options to vest.

The performance test will be performed on the third, fourth and fifth anniversaries.

The performance criteria for the options granted in 2003 are that:

- an average closing mid-share price over a period of 30 days leading up to the performance testing date of 250p for one third of the options to vest;
- confirmation of a production decision by a major car manufacturer and/or Tier 1 transmission supplier for one third of the options to vest;
- market launch of the Torotrak IVT in series production vehicles for the final third of the options to vest.

At 31 March 2004, employees held options to acquire 3,314,089 shares under the share option schemes, representing 2.83% of the allotted share capital as follows:

Grant date	Number of employees	Number of shares	Exercise price
Unapproved scheme			
July 1998	26	718,098	£3.40
Aug 1998	6	6,307	£2.625
June 1999	3	27,858	£1.565
Dec 1999	7	63,007	£2.69
July 2000	7	31,676	£3.765
Dec 2000	2	15,346	£1.29
July 2001	2	7,454	£1.69
Aug 2002	2	37,930	£0.47
Jan 2003	1	393,659	£0.205
Mar 2003	1	121,452	£0.155
Approved scheme			
Aug 1998	35	259,387	£2.625
Jun 1999	17	130,322	£1.565
Dec 1999	9	73,002	£2.69
July 2000	9	55,027	£3.765
Dec 2000	6	46,962	£1.29
July 2001	4	31,894	£1.69
Aug 2002	77	804,881	£0.47
Dec 2002	11	83,938	£0.25
Jan 2003	1	146,341	£0.205
Mar 2003	1	193,548	£0.155
June 2003	4	36,000	£0.27
Dec 2003	4	30,000	£0.80

Long-term incentive plan

The company has established a long-term incentive plan ('LTIP') for the benefit of UK and non-UK resident directors and employees. At 31 March 2004 no awards have been made under the scheme.

Share Incentive Plan

Awards made under the plan enjoy tax-favoured treatment and encourage long-term employee share ownership. During the year, an award of free shares was made under the plan which was performance related.

At 31 March 2004, 140,225 shares (2003: 75,892) in the company, with a market value of £100,962 (2003: £11,763) were held in trust on behalf of participating employees. The trustee is Torotrak (Trustee) Ltd, a subsidiary of Torotrak plc.

The Torotrak Employee Share Trust

The Torotrak Employee Share Trust ('the EST') is a discretionary trust established for the benefit of past, present and future employees of the group and their immediate families. The trustee is Bacon & Woodrow Trust Company (CI) Limited. The trustee can distribute shares at its discretion, on the recommendation of the board, either directly to a beneficiary or through the company's share schemes. All administrative costs associated with the EST are met by the company.

At 1 April 2003 and 31 March 2004, the EST held 17,500 shares in the company as part of the arrangements for compensating directors and employees of the group who retained options granted by BTG, the former parent company, under the BTG employee share schemes for the diminution in value of those options following the demerger in 1998.

directors' report cont...

On 1 July 2003 the trustees distributed 440,000 shares (before tax) to 100 employees of the company including the executive directors, Dick Elsy, Rebecca Joyce and David Price who were awarded 30,000, 15,000 and 15,000 shares respectively. These awards are shown as share bonus in the remuneration report. The market price of the shares on 1 July 2003 was £0.27 per share and the market value of the shares distributed was £118,800.

As part of the payment in connection with the termination of services as a director the trustees distributed 25,000 shares (before tax) to former director, Maurice Martin, on 18 July 2003. The agreed market price of the shares was £0.47 per share and the market value of the shares distributed was £11,750.

During the year the trustees distributed 53,000 shares (before tax) to certain former employees of the group.

All of the distributions during the year have been charged to operating loss at market value in accordance with UITF 17.

At 31 March 2004 the EST owned 2,069,079 shares (2003: 2,562,248) in the company with a nominal value of £0.2m (2003: £0.3m) and a market value of £1.5m (2003: £0.4m) representing 1.76% (2003: 2.2%) of the allotted share capital of the company. Except as detailed above none of the shares held were under option or conditionally gifted.

Payment to creditors

The group does not follow any code or standard on payment practice but it is group policy to pay all of its suppliers at the end of the month following the month of invoice. Terms of payment are stipulated in the group's terms and conditions of purchase.

At 31 March 2004 the number of days purchases outstanding to trade creditors was 7 for the group and 2 for the company (2003: 10 days and 8 days respectively).

Employment policies and donations

Details of the group's policies on employment of disabled persons and employee involvement and of charitable and political donations are given in the corporate responsibility report on page 11.

Substantial shareholdings

At 24 May 2004 the company had been notified of material interests held, directly or indirectly, in 3% or more of the company's allotted share capital by Henderson Investors Limited (8.60%) and Scottish Widows Investment Partnership Limited (3.17%).

Annual general meeting

The sixth annual general meeting of the company will be held at 12 noon on Thursday 22 July 2004 at 1 Aston Way, Leyland, Lancashire, PR26 7UX. The notice of the annual general meeting is on pages 41 and 42 of this report.

The company will convey the results of proxy votes cast at the annual general meeting. Shareholders are invited to submit written questions in advance of the meeting. Questions should be sent to the Company Secretary, Torotrak plc, 1 Aston Way, Leyland, Lancashire, PR26 7UX.

The auditors, KPMG Audit Plc, have indicated their willingness to continue in office and in accordance with S284 Companies Act 1985. Resolution 8 proposes to re-appoint them and authorises the directors to agree its remuneration.

Resolutions 9 to 11 renew the authorities given to the directors at the previous annual general meeting relating to the issue, allotment and purchase of the company's shares. The directors have no present intention to issue shares in the company other than pursuant to the terms of Torotrak's share option schemes.

By order of the board

Rebecca Joyce
Secretary
24 May 2004

1 Aston Way,
Leyland,
Lancashire,
PR26 7UX

remuneration report

Membership and constitution of the remuneration committee

The remuneration committee consists exclusively of independent non-executive directors. The committee is chaired by Nick Barter and its other members are David Wallis, John Grant and David MacKay.

The remuneration committee is responsible for recommending to the board all aspects of executive directors compensation, drawing on data provided by external advisors (New Bridge Street Consultants, Incomes Data Services and Independent Remuneration Solutions), and internal expertise. The committee consults with the chief executive on the remuneration of the executive directors and directors of subsidiaries. The board has accepted all of the remuneration committee's recommendations throughout the year.

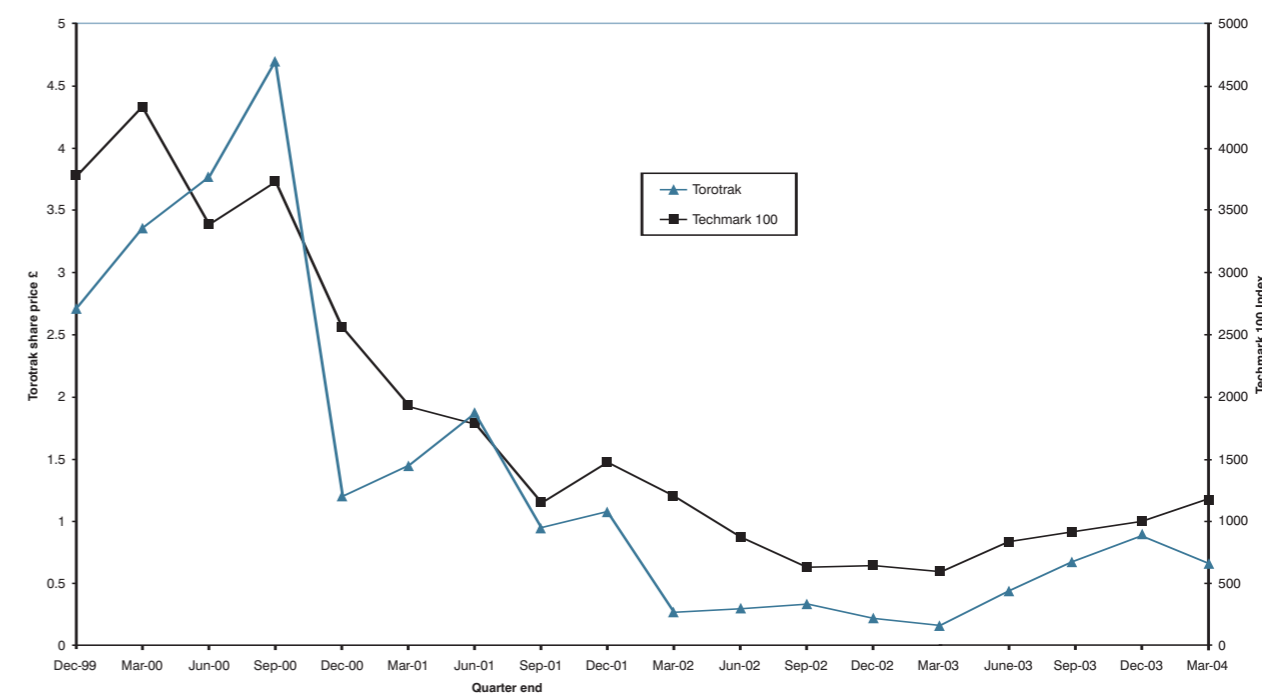
Remuneration policy

The objective of the remuneration policy is to provide remuneration in a form and amount that will attract, retain, motivate and reward high calibre directors and senior management. The committee believes that base salary and benefits for executive directors should represent a fair return for employment, but that over time a substantial proportion of the total reward should be derived from performance-related elements of the remuneration package.

The performance-related elements of the executive directors' packages seek to align their interests closely with those of shareholders and provide incentives for performance. They are also designed to be long term in their nature.

Performance chart

The chart below compares the total cumulative shareholder return of Torotrak plc with the performance of the FTSE Techmark 100 index since the inception of the index in 1999. The committee is of the view that the FTSE Techmark 100 index constitutes a relevant broad equity market index.



remuneration report cont...

Executive directors' employment contracts

The notice period in all executive directors' employment contracts is 12 months. There are no provisions for compensation on early termination in any of the executive directors' employment contracts.

Executive directors' remuneration packages

Details of individual executive directors' remuneration are included in the table on page 23. Remuneration packages for executive directors consist of the following elements:

Base salary and benefits

Salaries are reviewed annually taking account of personal performance and the prevailing rates in the employment market for executives of comparable status, responsibility, skill and position in other companies whilst having due regard for salary levels and employment conditions across the group.

Benefits are health insurance and car benefits (which are subject to income tax), permanent health insurance and life insurance.

Performance-related share bonus

The level of share bonus (if any) recommended by the committee is determined on the basis of operational targets established at the beginning of each financial year. The share bonus is distributed from shares held by the Employee Share Trust. Further details of the Employee Share Trust are given in the directors' report on page 19.

The share bonus is determined as a number of shares. The value of the bonus is dependent on the market price on the date of the award. As a consequence the performance-related element of executive directors' remuneration varies from year to year in accordance with the share price on the date of the award. In 2004 the performance-related element of executive directors' remuneration was 3% (2003: 3%).

Pensions policy

The Torotrak pension scheme is a defined contribution money purchase scheme that is open to all employees of the group. Executive directors have the option of having their contributions paid in to a personal pension scheme of their choice. Pension contributions are made on basic salary only.

Share option schemes

The company operates the Torotrak approved and unapproved share option schemes and the Torotrak savings related share option scheme, details of which are given in the directors' report on pages 18 and 19. Under the schemes, options over the company's ordinary shares may be granted to all employees, including executive directors. Exercise of options granted under the approved and unapproved schemes are subject to satisfaction of the performance criteria which are given in the directors' report on page 18. Options granted to the executive directors are set out on page 23.

Non-executive directors

The remuneration of non-executive directors is determined by the board within the limits set out in the articles of association. The non-executive directors are not eligible for bonuses and do not participate in the share option schemes. The non-executive directors do not have service contracts; their letters of appointment contain a notice period of three months.

Details of individual non-executive directors' remuneration are included in the table on page 23. In the case of the chairman, part of his remuneration is paid to a company nominated by him.

Directors' remuneration (audited information)

	Salary and benefits £000	Fees £000	Share bonus £000	Total (excl pension) 2004 £000	Company pension £000	Total (incl pension) 2004 £000	Total 2003 £000
Executive directors							
Dick Elsy note (i)	226	-	8	234	30	264	57
Rebecca Joyce	130	-	4	134	19	153	145
David Price note (i)	114	-	4	118	17	135	67
James Batchelor note (i)	113	-	-	113	17	130	-
David Wallis note (ii)	-	-	-	-	-	-	58
Maurice Martin note (iii)	-	-	-	-	-	-	321
Non-executive directors							
David Wallis	-	45	-	45	-	45	45
Malcolm Coster note (iv)	-	11	-	11	-	11	25
John Grant	-	19	-	19	-	19	18
Ian Macpherson note (iv)	-	13	-	13	-	13	20
David Burnicle note (iv)	-	11	-	11	-	11	18
Nick Barter note (v)	-	8	-	8	-	8	-
David MacKay note (v)	-	8	-	8	-	8	-
Total directors' emoluments	583	115	16	714	83	797	774

Notes:

(i) 2003: from date of appointment (ii) 2003: as acting chief executive (iii) 2003: to expiry of employment contract (iv) to date of resignation (v) from date of appointment

Share options (audited information)

The number of options over Torotrak plc shares held by the executive directors under the approved and unapproved share option schemes and the savings related share option scheme were as follows:

	Notes	At 1 April 2003 Number	Granted during the year Number	Lapsed during the year Number	At 31 March 2004 Number	Exercise price £	Expiry date
Dick Elsy	(i) (ii)	540,000	-	-	540,000	0.205	Jan 2013
Rebecca Joyce	(i)	162,940	-	-	162,940	3.40	July 2008
	(i) (ii)	92,058	-	-	92,058	0.47	July 2012
	(iii)	42,857	-	-	42,857	0.21	Sep 2005
David Price	(ii)	67,646	-	-	67,646	3.40	July 2008
	(i)	2,018	-	-	2,018	2.625	July 2008
	(i)	41,753	-	-	41,753	0.47	July 2012
	(i)	20,305	-	-	20,305	0.25	Dec 2012
	(iii)	42,857	-	-	42,857	0.21	Sep 2005
James Batchelor	(i) (ii)	315,000	-	-	315,000	0.155	Mar 2013

Notes: (i) approved (ii) unapproved (iii) sharesave

The performance criteria applicable to the approved and unapproved share option schemes before the options can be exercised are detailed in the directors' report on page 18.

The mid-market price of the ordinary shares at 31 March 2004 was £0.72. During the year the highest mid-market price was £1.25 and the lowest was £0.17.

Directors' interests in share capital (audited information)

The interests of the directors (including beneficial interests) in the share capital of the company at 31 March 2004 were as follows:

	31 March 2004 No. of shares	31 March 2003 or date of appointment No. of shares
David Wallis	46,681	46,681
Dick Elsy	116,658	86,658
Rebecca Joyce	99,140	84,140
David Price	26,463	11,463
James Batchelor	–	–
John Grant	226,003	226,003
Nick Barter	28,374	–
David MacKay	–	–

There have been no changes to any directors' interests in the share capital of the company between 31 March 2004 and the date of this report.

Approved by the board and signed on its behalf by:

Nick Barter

Chairman of the remuneration committee.

Statement of directors' responsibilities

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

- Select suitable accounting policies and apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Independent auditors' report to the members of Torotrak plc

We have audited the financial statements on pages 26 to 39. We have also audited the information in the 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 are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 24 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be 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 financial statements, if the group 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 or the Listing Rules regarding directors' remuneration and transactions with the group is not disclosed.

We review whether the statement on pages 14 to 17 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with 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 and the part of the directors' remuneration reported to be audited. 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 mis-statement, 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 and the part of the directors' remuneration report to be audited.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group as at 31 March 2004 and of the loss of the group for the year then ended; and the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc,
Chartered Accountants
Registered Auditor,
Preston
24 May 2004

accounts 2004

Consolidated profit and loss account

for the year ended 31 March 2004

	Notes	2004 £000	2003 £000
Turnover	1	244	145
Development expenses		(5,758)	(5,205)
Administrative expenses		(2,033)	(2,084)
Operating loss		(7,547)	(7,144)
Net interest receivable	6	522	764
Loss on ordinary activities before taxation	2	(7,025)	(6,380)
Taxation	7	859	800
Loss on ordinary activities after taxation retained for the financial year	17	(6,166)	(5,580)
Loss per share	9	(5.36p)	(4.88p)
Diluted loss per share	9	(5.36p)	(4.88p)

All of the results derive from continuing operations during the current and previous year.
There were no recognised gains and losses in the current and previous year other than those reported above.
The accounting policies and notes on pages 29 to 39 form part of these financial statements.

Balance sheets

as at 31 March 2004

	Notes	Group 2004 £000	Group 2003 £000	Company 2004 £000	Company 2003 £000
Fixed assets					
Intangible assets - Patents	10	877	863	-	-
Tangible assets	11	6,044	6,524	-	-
Investments	12	-	-	9,270	9,270
		6,921	7,387	9,270	9,270
Current assets					
Debtors	13	1,251	2,372	48,632	43,370
Investments - Money market deposits		10,031	15,279	10,031	15,279
Cash at bank and in hand		1,698	1,040	-	1
		12,980	18,691	58,663	58,650
Creditors					
Amounts falling due within one year	14	(543)	(718)	(2,879)	(2,893)
Net current assets		12,437	17,973	55,784	55,757
Total assets less current liabilities		19,358	25,360	65,054	65,027
Capital and reserves					
Called up share capital	16	11,718	11,707	11,718	11,707
Share premium account	17	47,997	47,986	47,997	47,986
Other reserve	17	(3,807)	(4,571)	(3,807)	(4,571)
Profit and loss account	17	(36,550)	(29,762)	9,146	9,905
Equity shareholders' funds	18	19,358	25,360	65,054	65,027

The accounting policies and notes on pages 29 to 39 form part of these financial statements.

The financial statements were approved by the board of directors on 24 May 2004 and signed on its behalf by:



Rebecca Joyce
Finance director

accounting policies

Consolidated cashflow statement

for the year ended 31 March 2004

	Notes	2004 £000	2003 £000
Net cash outflow from operating activities	22	(6,795)	(6,270)
Return on investments and servicing of finance			
Interest received		505	836
Net cash inflow from returns on investments and servicing of finance		505	836
Taxation		2,016	1,447
Capital expenditure			
Purchase of tangible fixed assets		(145)	(256)
Proceeds from sale of tangible fixed assets		13	7
Investment in patents		(184)	(162)
Net cash outflow on capital expenditure		(316)	(411)
Net cash outflow before management of liquid resources and financing		(4,590)	(4,398)
Management of liquid resources			
Cash withdrawn from money market		5,248	5,221
Increase in cash in the year	23	658	823

The accounting policies and notes on pages 29 to 39 form part of these financial statements.

The accounting policies deal with items that are judged material in determining the loss for the year and in stating the financial position. The following paragraphs describe the principal accounting policies of the group and have been applied consistently.

Basis of accounting

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards.

Basis of consolidation

The financial statements consolidate the financial statements of the company and its subsidiaries, all of which are made up to 31 March.

Treatment of foreign currencies

Transactions denominated in foreign currencies are translated into sterling and recorded at the rate of exchange ruling at the date of the transaction. Assets and liabilities outstanding at the year end have been translated using year end rates and profits and losses arising have been taken to the profit and loss account.

Patent and other intellectual property rights

Patents are stated at cost less amortisation. Cost includes the cost of obtaining patent protection for intellectual property rights (IPR) on technologies arising from inventive ideas. Income from patents is derived through licensing and other agreements.

Such expenditure is amortised in a manner calculated to write off the cost, in equal annual proportions, over the effective life of the underlying patent or other IPR up to a maximum of 20 years. In the event that a patent is abandoned or is considered to have suffered an impairment in value at any time before the expiry of its granted life, the balance of unamortised expenditure is written off in the year in which such abandonment takes place.

Cash and liquid resources

Cash, for the purposes of the cashflow statement, comprises cash in hand and deposits repayable on demand, less overdrafts repayable on demand. Liquid resources comprise investments in money market managed funds which mature within one year of the date of investment.

Depreciation

Freehold land is not depreciated. Other tangible fixed assets are stated at cost less depreciation, which is calculated to write off the cost less estimated residual value of fixed assets over their estimated useful lives on a straight line basis, at the following rates per annum:

	%
Plant, machinery & equipment	25
Cars	25
Computer hardware	33 1/3
Computer software	33 1/3
Office furniture and fittings	20
Test vehicles	50
Freehold buildings	2 1/2

notes to the accounts

Investments

Investments are carried at cost, less provisions for impairment.

Pension costs

The pension scheme operated by the group is a defined contribution money purchase scheme and pension costs are charged to the profit and loss account in respect of the period to which they relate.

Research & development

Research & development expenditure is written off as incurred.

Leases

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Long-term contracts

The amount of profit attributed to the stage of completion of a long-term contract is recognised when the outcome of the contract can be foreseen with reasonable certainty. Turnover for such contracts is stated at cost appropriate to their stage of completion plus attributable profits, less amounts recognised in previous years. Provision is made for any losses which are foreseeable.

Contract work in progress is stated at costs incurred, less those transferred to the profit and loss account, after deducting foreseeable losses and payments on account not matched with turnover.

Amounts recoverable on contracts are included in debtors and represent turnover recognised in excess of payments on account.

Taxation

The charge/credit for taxation is based on the profit/loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required in FRS 19.

Related party transactions

The group has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which have been eliminated on consolidation.

Financial instruments

Short-term debtors and creditors that meet the definition of a financial asset or liability respectively have been excluded from FRS 13 analysis where permitted by that standard.

Employee share schemes

The cost of awards to employees that take the form of shares or rights to shares are recognised over the period of the employee's related performance. Where there are no future performance criteria the cost is recognised when the employee becomes unconditionally entitled to shares. No cost is recognised in respect of Sharesave schemes that are offered on similar terms to all or substantially all employees.

1. Turnover and segmental analysis

Turnover consists of income from exploitation of the group's technology. There were no sales between group companies. The source of all turnover, loss before taxation and net assets is the UK.

Turnover by destination is analysed below:

	31 March 2004 £000	31 March 2003 £000
Europe	115	91
Far East	129	54
	244	145

2. Loss on ordinary activities before taxation

Loss on ordinary activities before taxation, is stated after charging:

	31 March 2004 £000	31 March 2003 £000
Patent renewal fees	190	170
Amortisation of patent costs	98	73
Depreciation of tangible fixed assets - owned	680	721
Auditors' remuneration	33	32
- audit (group)		
- audit (company)	5	5
- fees for other services to the auditors and their associates	11	16
Research and development costs	5,758	4,853

3. Directors' remuneration

	31 March 2004 £000	31 March 2003 £000
Directors' emoluments	714	501
Company contributions to pension schemes	83	45
Amounts paid and payable in connection with termination of qualifying services as a director	-	228
	797	774

More detailed information concerning directors' remuneration, shareholdings, options and pension benefits is shown in the remuneration report on pages 21 to 24.

notes to the accounts cont...

4. Employee costs and numbers

The aggregated payroll costs (including directors' emoluments) were as follows:

	31 March 2004 £000	31 March 2003 £000
Salaries	3,614	3,456
Social security costs	406	360
Pension costs	417	301
	4,437	4,117

The average number of persons employed (including executive and non-executive directors) during the year analysed by category was as follows:

	31 March 2004	31 March 2003
Directors - company	8	7
- subsidiaries	3	5
Engineers	80	79
Administrative	18	18
	109	109

5. Pension fund

The group operates a defined contribution money purchase scheme for its staff which was set up on 1 January 1988. The assets of the scheme are held separately from the group in an independently administered fund with Standard Life as trustee. The scheme has been contracted into the State Earnings Related Pension Scheme since 6 April 1997. Pension charges are charged to the profit and loss account in respect of the period to which they relate. The charge to the profit and loss account was £349,000 (2003: £293,000). The scheme is available to all full-time employees aged between 18 and 64 years and currently has approximately 86 members. Retirement age is between 60 and 75 years. The minimum contribution rates as a percentage of basic earnings calculated at 6 June each year are 7.5 per cent by Torotrak and 3.5 per cent by the relevant employee. The maximum pension on retirement is 1/30th of final earnings for each year of service up to 20 years. The part of a pension bought with contributions paid after 5 April 1997 must increase by at least 5 per cent, in line with the cost of living. Part of the pension may be received as a tax-free cash sum. The maximum amount is the greater of (i) 3/80ths of the final salary for each year of service with a maximum of 40 years; and (ii) 2.25 times the initial pension amount. The scheme is not the subject of any investigation by the Occupational Pension Regulatory Authority or subject to any litigation or claim before the Pensions Ombudsman and complies with the requirements of the Pensions Act 1995. There were no payments due at the year end.

Executive directors, directors of subsidiaries and certain employees are entitled to have pension contributions payable by the group paid in to a personal pension scheme. The charge to the profit and loss account was £68,000 (2003: £96,000).

6. Net interest receivable

	31 March 2004 £000	31 March 2003 £000
Bank interest receivable	522	764

7. Taxation on loss on ordinary activities

	31 March 2004 £000	31 March 2003 £000
UK corporation tax		
Current tax for the year	859	800
Total current tax	859	800
Deferred tax	-	-
	859	800

Factors affecting the tax credit for the current period:

The Finance Act 2000 introduced the Research and Development Tax Credit which allows companies with qualifying expenditure to surrender their tax losses for cash. The effective tax rate for these credits is 24% compared to the current UK corporation tax rate of 30%.

The current tax credit for the period is lower (2003: lower) than the standard rate of corporation tax in the UK of 30% (2003: 30%). The differences are as follows:

	31 March 2004 £000	31 March 2003 £000
Loss before taxation	(7,025)	(6,280)
Expected current tax credit at 30% (2003: 30%)	2,108	1,884
Expenses not deductible for tax purposes	(72)	(54)
Depreciation in excess of capital allowances	(135)	(186)
R & D tax credit given at an effective rate of 24%	(215)	(201)
Tax losses carried forward	(827)	(643)
Total current tax credit	859	800

Factors that may affect future tax credits/(charges):

Future tax credits/(charges) will depend on the continued availability of the tax credit in respect of research and development expenditure. In addition, the group has approximately £24m of tax losses and approximately £7m of unclaimed capital allowances that may be offset against future taxable profits. If the tax credit in respect of research and development expenditure is not available in the future, or is not claimed, the tax losses available for offset against future taxable profits would be increased.

notes to the accounts cont...

8. Loss for the financial period

No profit and loss account is presented for the company as permitted by section 230(4) of the Companies Act 1985. The company's loss for the year was £137,000 (2003: profit £69,000).

9. Loss per ordinary share

Basic loss per share is based on the loss after tax of £6,166,000 (2003: £5,580,000) and 115.1 million ordinary shares (2003: 114.4 million) being the weighted average number of shares in issue during the year.

Reconciliation of the weighted average number of shares used in calculating basic loss per share and that used in calculating diluted loss per share:

	31 March 2004 Number	31 March 2003 Number
Shares issued and used in calculating basic and diluted loss per share	115,107,042	114,359,780

In accordance with FRS14 number of shares used in the calculation excludes shares held by the Employee Share Trust.

10. Intangible assets – Patents

	31 March 2004 £000	31 March 2003 £000
Cost		
At 1 April	1,394	1,254
Expenditure in year	182	149
Abandoned in year	(117)	(9)
At 31 March	1,459	1,394
Amortisation		
At 1 April	531	467
Charge for the year	98	73
Abandoned in year	(47)	(9)
At 31 March	582	531
Net book value at 31 March	877	863

11. Tangible assets

	Freehold land and buildings £000	Office furniture and fittings £000	Plant, machinery and equipment £000	Computer equipment £000	Test vehicles £000	Total £000
Cost						
At 1 April 2003	6,368	134	4,147	1,944	304	12,897
Additions	4	–	49	92	–	145
Disposals	–	–	(98)	(134)	–	(232)
Transfers	–	–	15	(15)	–	–
At 31 March 2004	6,372	134	4,113	1,887	304	12,810
Depreciation						
At 1 April 2003	555	112	3,659	1,743	304	6,373
Charge for the year	145	17	326	114	–	602
Disposals	–	–	(77)	(132)	–	(209)
At 31 March 2004	700	129	3,908	1,725	304	6,766
Net book value						
At 31 March 2004	5,672	5	205	162	–	6,044
At 31 March 2003	5,813	22	488	201	–	6,524

Freehold land and buildings includes land, which is not depreciated, at a cost of £551,000 (2003: £551,000).

12. Investments

	Shares in subsidiary undertakings £000	Company Total £000
Cost and net book value		
At 1 April 2003 and 31 March 2004	9,270	9,270

Details of subsidiary undertakings are set out in note 27.

13. Debtors

	Group 31 March 2004 £000	Group 31 March 2003 £000	Company 31 March 2004 £000	Company 31 March 2003 £000
Amounts owed by subsidiary undertakings	–	–	48,515	43,274
Trade debtors	147	51	–	–
Other debtors and prepayments	1,104	2,321	117	96
	1,251	2,372	48,632	43,370

Other debtors include UK corporation tax of £0.8 million (2003: £2.0 million). Further details are set in out note 7.

Amounts owed by subsidiary undertakings are recoverable on demand but are expected to be recovered after more than one year.

notes to the accounts cont...

14. Creditors: amounts falling due within one year

	Group 31 March 2004 £000	Group 31 March 2003 £000	Company 31 March 2004 £000	Company 31 March 2003 £000
Trade creditors	56	105	-	-
Amounts owed to subsidiary undertakings	-	-	2,798	2,797
Accruals and deferred income	487	613	81	96
	543	718	2,879	2,893

15. Deferred taxation

	Group 2004 £000	Group 2003 £000
Accelerated allowances on patents and other IPR	263	259
Other - available losses	(239)	(235)
- timing differences	(24)	(24)
	-	-

There is no deferred tax in respect of the company.

16. Share capital

	Number	31 March 2004 £000	31 March 2003 £000
Authorised			
Ordinary shares of 10p each	200,000,000	20,000	20,000
Allotted and fully paid			
Ordinary shares of 10p each	117,176,121	11,718	11,707

Details of ordinary shares under option under the company's employee share schemes are included in the directors' report on pages 18 and 19.

108,059 shares were allotted during the year pursuant to the exercise of options granted under the sharesave scheme by certain former employees. The nominal value of the shares allotted was £10,805 and the consideration received was £22,692.

17. Movement in reserves

	Group and Company Share premium account £000	Group and Company Other reserve £000	Group Profit and loss account £000	Company Profit and loss account £000
At 1 April 2003	47,986	(4,571)	(29,762)	9,905
Movements during the year:				
Employee Share Trust - share award	-	764	(622)	(622)
Shares issued	11	-	-	-
Loss for the financial year	-	-	(6,166)	(137)
At 31 March 2004	47,997	(3,807)	(36,550)	9,146

Details of the share award by the Employee Share Trust are given in the directors' report on page 19 and 20.

Other reserve

The other reserve represents 2,068,073 ordinary shares of 10p each issued to the Employee Share Trust in 2001 at a price of £1.84 which have been written off. As the Employee Share Trust distributes these shares to the beneficiaries of the trust (principally the employees) an amount will be transferred between the other reserve and the profit and loss account reserve.

18. Reconciliations of movements in shareholders' funds

	Group 31 March 2004 £000	Group 31 March 2003 £000	Company 31 March 2004 £000	Company 31 March 2003 £000
Opening shareholders' funds	25,360	30,822	65,027	64,840
(Loss)/profit for the financial year	(6,166)	(5,580)	(137)	69
Shares issued	23	-	23	-
Share award by Employee Share Trust	141	118	141	118
Closing shareholders' funds	19,358	25,360	65,054	65,027

19. Operating lease commitments

	31 March 2004 £000	31 March 2003 £000
Operating leases which expire between 2 and 5 years	53	12

20. Capital commitments

At 31 March 2004 capital commitments totalled £2,400 (2003: £6,000).

notes to the accounts cont...

21. Significant contracts

Under an agreement dated 6 July 1998 between the group and BTG International Ltd ('BTG') the group has agreed to pay a certain percentage (not exceeding 5 per cent and subject to specified thresholds) of aggregate turnover to BTG. Turnover for the purposes of this agreement is derived from exploitation of the group's intellectual property rights. Principal exclusions from the definition of turnover are income derived from providing research, evaluation or consultancy services or any business not carried on by the group at the time of demerger.

The agreement terminates on 30 June 2020. Total payments made to BTG under the terms of the agreement for the period since demerger are £10,564 (2003: £10,064).

22. Reconciliation of operating loss to net cash outflow from operating activities

	31 March 2004 £000	31 March 2003 £000
Operating loss	(7,547)	(7,144)
Depreciation charge	602	721
Amortisation charge	98	73
Share award by Employee Share Trust	141	153
Loss on sale of fixed assets	93	46
Increase in debtors	(13)	(35)
Decrease in creditors	(169)	(84)
Net cash outflow from operating activities	(6,795)	(6,270)

23. Analysis of changes in cash

	31 March 2004 £000	31 March 2003 £000
As at 1 April - cash at bank and in hand	1,040	217
As at 31 March - cash at bank and in hand	1,698	1,040
Increase in cash	658	823

24. Analysis of net funds

	Balance at 1 April 2003 £000	Cashflow £000	Balance at 31 March 2004 £000
Cash at bank and in hand	1,040	658	1,698
Money market deposits	15,279	(5,248)	10,031
Net funds	16,319	(4,590)	11,729

25. Reconciliation of net cash flow to movement in net funds

	31 March 2004 £000	31 March 2003 £000
Increase in cash in the year	658	823
Withdrawn from money market	(5,248)	(5,221)
Movement in net funds in the period	(4,590)	(4,398)
Net funds at 1 April	16,319	20,717
Net funds at 31 March	11,729	16,319

26. Financial instruments

Details of the group's treasury objectives and policies can be found in the finance director's review on page 10. The group has no financial liabilities other than short term creditors. Disclosure dealt with in this note excludes short term debtors and creditors where permitted by FRS 13.

The profile of the financial assets of the group was:

	31 March 2004 £000	31 March 2003 £000
Cash	1,698	1,040
Sterling cash deposits	10,031	15,279
	11,729	16,319

The sterling cash deposits comprise deposits placed on money markets at call and terms up to six months. The weighted average interest rate on the deposits is 3.66% (2003: 3.52%) and the weighted average time for which the rate is fixed is 3.1 months (2003: 3.1 months).

27. Subsidiary undertakings

The subsidiary undertakings of the company at 31 March 2004, all of which are wholly owned and incorporated in Great Britain and registered in England and Wales, are as follows:

	Class of capital	Principal activity
Torotrak Group Ltd	Ordinary	Intermediate holding company
Torotrak (Holdings) Ltd	Ordinary	Commercialisation of infinitely variable transmission technology
Torotrak (Development) Ltd	Ordinary	Research and development of infinitely variable transmissions
Torotrak (Property) Ltd	Ordinary	Ownership of land & buildings
Torotrak (Trustee) Ltd	Ordinary	Trustee of shares held under the Share Incentive Plan (formerly All Employee Share Ownership Plan)

The investments in Torotrak Group Ltd and Torotrak (Trustee) Ltd are held by the company. The investments in all other subsidiaries are held through Torotrak Group Ltd.

financial record

For the years ended 31 March

	2004 £000	2003 £000	2002 £000	2001 £000	2000 £000
Turnover	244	145	214	187	594
Loss on ordinary activities before taxation	(7,025)	(6,380)	(4,057)	(8,227)	(8,485)
Loss on ordinary activities after taxation retained for the financial year	(6,166)	(5,580)	(1,410)	(8,228)	(8,505)
Loss per share	(5.36p)	(4.88p)	(1.24p)	(7.25p)	(7.51p)
Diluted loss per share	(5.36p)	(4.88p)	(1.24p)	(7.25p)	(7.51p)
Total assets less current liabilities	19,358	25,360	30,822	31,407	39,635
Equity shareholders' funds	19,358	25,360	30,822	31,407	39,635
Net cash outflow from operating activities	(6,795)	(6,270)	(7,740)	(8,638)	(8,360)
Management of liquid resources	5,428	5,221	2,267	9,603	7,609
Increase/(decrease) in cash in each year	658	823	(45)	217	(456)

Financial calendar

Annual general meeting	22 July 2004
Interim results announcement	November 2004
Interim report posted to shareholders	November 2004

notice of annual general meeting

Notice is hereby given that the sixth annual general meeting of the company will be held at 1, Aston Way, Leyland, Lancashire, PR26 7UX on 22 July 2004 at 12 noon for the following purposes:

1. To receive and adopt the accounts and the reports of the directors and auditors for the year ended 31 March 2004 (resolution 1).
2. To approve the remuneration report (resolution 2).
3. To approve the remuneration policy set out in the remuneration report (resolution 3).
4. To elect as directors Dr Nicolas Barter and Mr David MacKay on the recommendation of the board (resolutions 4 and 5).
5. To re-elect as directors Mrs Rebecca Joyce and Mr John Grant who retire as directors in accordance with the company's articles of association (resolutions 6 and 7).
6. To re-appoint KPMG Audit Plc as auditors and to authorise the directors to agree its remuneration (resolution 8).

Special business

To consider and, if thought fit, to pass the following resolutions of which resolution 9 will be proposed as an ordinary resolution; resolutions 10 and 11 will be proposed as special resolutions:

7. That the directors be and they are hereby generally and unconditionally authorised to exercise powers of the company to allot, grant options over, offer or otherwise deal with or dispose of relevant securities (within the meaning of section 80 of the Companies Act 1985) up to an amount equal to 33 percent of the aggregate nominal value of the ordinary shares in issue at 24 May 2004 with an aggregate nominal value of £3,866,811 provided that: (a) this authority shall expire at the close of the next annual general meeting of the company after passing of this resolution unless previously renewed, varied or revoked by the company in general meeting save that before such expiry the company may make any offer or agreement which would or might require relevant securities of the company to be allotted after such expiry and the directors may allot relevant securities in pursuance of such offer or agreement as if the authority conferred by this resolution had not expired; and the authority conferred by this resolution shall be in substitution for all existing powers conferred on the directors pursuant to the said section 80 (resolution 9).
8. That, subject to the passing of resolution 9, the directors be and they are hereby empowered pursuant to section 95 of the Companies Act 1985 to allot equity securities (within the meaning of section 94 of the said Act) for cash pursuant to the authority conferred by the foregoing resolution as if sub-section (1) of section 89 of the said Act did not apply to any such allotment provided that this power shall be limited: (a) to the allotment of equity securities in connection with a rights issue in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as may be but subject to such exclusions or other arrangements as the directors may deem necessary or desirable to deal with fractional entitlement or legal or practical problems under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory) to the respective number of ordinary shares held by them; and to the allotment (otherwise than pursuant to sub-paragraph (a) above) of equity securities up to an amount equal to 5 per cent of the aggregate nominal value of the ordinary shares in issue at 24 May 2004 with an aggregate nominal value of £585,880 and shall expire at the close of the next annual general meeting of the company after passing of this resolution save that the company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities in pursuance of such an offer or agreement as if the power conferred hereby had not expired (resolution 10).
9. That, in accordance with regulation 52(4) of the articles of association, a general authority is hereby given for the purposes of section 166 of the Companies Act 1985 for market purchases (as defined in section 163 of the said Act) by the company of any of its ordinary shares subject to the following restrictions but otherwise unconditionally: (a) the maximum aggregate number of ordinary shares to be so acquired shall not exceed 11,717,612 ordinary shares of 10p each representing 10% of the ordinary shares in issue at 24 May 2004 ordinary shares may only be purchased at a price per share (exclusive of expenses) no higher than 5% above the average of the middle market quotations of the ordinary shares in the capital of the company, as derived from the London Stock Exchange Daily Official List, for the five business days preceding the date of purchase but the minimum price that may be paid for such shares shall be the nominal value of 10p per share (exclusive of expenses) this authority shall expire at the conclusion of the next annual general meeting of the company, but the company may before such expiry make contracts for such purposes which would or might be executed wholly or partly after such expiry (resolution 11).

1 Aston Way
Leyland
Lancashire
PR26 7UX

By order of the board
Rebecca Joyce
Secretary
24 May 2004

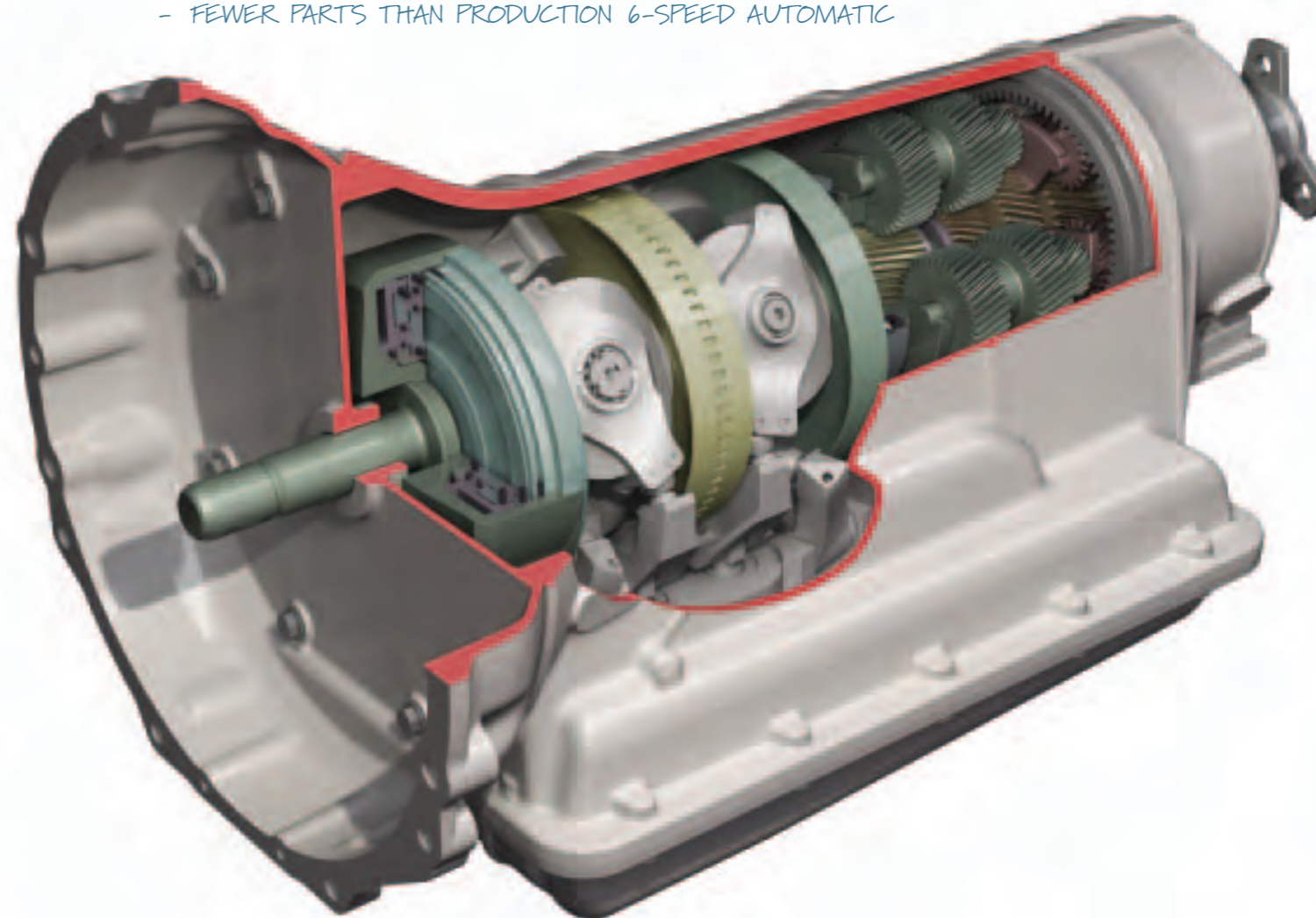
notice of annual general meeting

Notes

1. Biographical details of directors offering themselves for election or re-election (resolutions 4 to 7) are shown on pages 12 and 13.
2. Resolution 9, which is an ordinary resolution, renews the authority given to the directors at last year's annual general meeting to issue up to 1/3 of the current issued share capital.
3. Resolution 10, which is a special resolution, renews the authority given to the directors at last year's annual general meeting to allot up to 5% of the current issued share capital for cash without first being required to offer such securities to existing shareholders.
4. Resolution 11, which is a special resolution, renews the authority given to the directors at last year's annual general meeting and enables the company to purchase up to 10% of the current issued share capital.
5. Any member entitled to attend and vote at the annual general meeting may appoint one or more proxies to attend and, on a poll, to vote instead of him and such proxy need not be a member of the company. To be effective, the instrument appointing a proxy (and the power of attorney or other authority (if any) under which it is signed or a notarially certified or office copy thereof) must be deposited at Capita Registrar not less than 48 hours before the time of holding the meeting or adjourned meeting. Completion and return of the form of proxy will not preclude shareholders from attending the annual general meeting and voting in person if they wish to do so.
6. There will be available for inspection at the registered office of the company during normal business hours on any weekday, Saturdays excepted, from the date of this notice until the date of the meeting, and at 7 Devonshire Square, Cutlers Gardens, London EC2M 4YH from 9.00am on 24 July 2004 until the close of the meeting, copies of all directors' service contracts where the unexpired portion of the term exceeds twelve months or the contract is not determinable by the company within such period without the payment of compensation.

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