IQE 25 years

enabling advanced technologies

annual report & financial statements

Five year financial summary

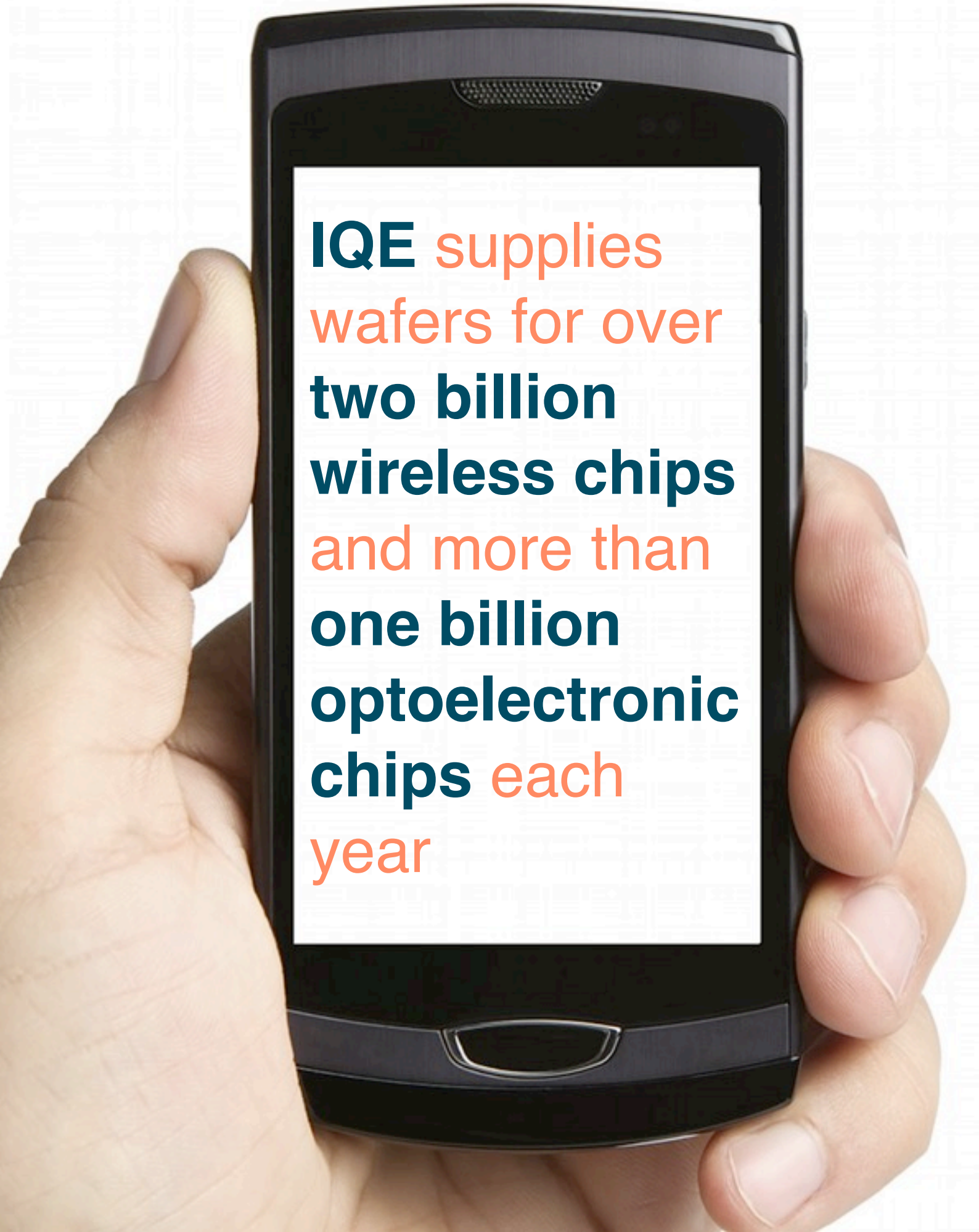
	2012 £'000	2011 £'000	2010 £'000	2009 £'000	2008 £'000
Revenue	87,961	75,318	72,650	52,652	60,485
EBITDA (see below)	16,437	13,955	13,115	8,051	8,407
Operating profit					
- Before exceptional items	7,584	7,373	7,208	3,044	4,000
- After exceptional items	7,014	7,373	7,208	3,044	69
Retained profit/(loss)					
- Before exceptional items	7,201	8,443	7,506	2,058	2,546
- After exceptional items	6,631	8,443	7,506	2,058	(1,385)
Net cash flow from operations					
- Before exceptional items	4,109	10,823	10,250	8,139	8,526
- After exceptional items	4,109	10,823	10,250	7,712	7,461
Free cash flow*					
- Before exceptional items	(2,139)	(8,585)	3,315	3,906	690
- After exceptional items	(2,139)	(8,585)	3,315	3,479	(375)
Net (debt) / funds	(15,483)	(3,921)	7,021	(14,931)	(18,135)
Shareholders' funds	90,189	72,750	62,274	29,837	30,218
EPS – adjusted**	1.59p	1.86p	1.91p	0.68p	0.79p
EPS – unadjusted	1.16p	1.62p	1.63p	0.47p	(0.32p)
Diluted EPS – adjusted**	1.51p	1.74p	1.76p	0.64p	0.79p
Diluted EPS – unadjusted	1.10p	1.51p	1.50p	0.44p	(0.32p)

* Free cash flow is defined as net cash flow before acquisitions, contingent deferred consideration (settled through contractual discounts), financing and net interest paid

** adjusted EPS measures exclude non-cash charges for share based payments, non-cash acquisition related charges and exceptional items (see note 9 to the accounts)

EBITDA has been calculated as follows:

	2012 £'000	2011 £'000	2010 £'000	2009 £'000	2008 £'000
Profit/(loss) after tax	6,631	8,443	7,506	2,058	(1,385)
Tax	(503)	(1,551)	(1,172)	-	-
Interest	886	481	874	986	1,454
Share based payments	1,360	1,284	1,302	898	884
Exceptional items	570	-	-	-	3,931
Depreciation	5,998	4,175	3,619	3,372	3,076
Amortisation of intangible assets	1,495	1,123	986	737	447
EBITDA	16,437	13,955	13,115	8,051	8,407


IQE supplies wafers for over two billion wireless chips and more than one billion optoelectronic chips each year

What's inside?

Successful completion of **three** strategic and **transformational deals** in twelve months

Chairman's statement

It is my pleasure to introduce IQE's Annual Report for 2012.

This year marks IQE's 25th anniversary. As I reflect on the technology changes over the past 25 years, I find the extent and pace of change remarkable, with advances in technology that have changed our lives in ways we could not have imagined 25 years ago.

In a single generation we have witnessed not only the birth of the internet, but we have seen it revolutionise the way we work, shop, entertain ourselves and even, for some at least, socialise. We have not only seen the introduction of mobile phones, with their brick-like form and voice-only capability, but we have witnessed this transform into the multi-function smart phone revolution of a hyper-connected world. We have experienced large industries which took generations to mature, seemingly disappear overnight: celluloid cameras displaced by digital, CDs emerge and are then replace by downloads.

What is also remarkable, is that it is semiconductors that has enabled every single one of these revolutions. Semiconductors are the fundamental building blocks of the electronics industry. But what is even more relevant to IQE is that these foundations are shifting. Silicon has been pushed to its fundamental limits, defined by the laws of physics, and it is already being superseded by advanced 'compound' semiconductors. Furthermore, what is inevitable is that the shift to compound semiconductors will only accelerate as mankind continues to innovate and demand faster, more efficient, and more powerful devices.

Akin to the emergence of the first portable phones, or the first digital cameras, we are starting to see glimpses of what lies ahead: revolutions in lighting, energy generation, gesture recognition, optical communication, and pico projection. Nevertheless, whilst it is difficult to anticipate the full extent of how technology will change our lives over the next 25 years, it is clear to me that compound semiconductors will be at the very heart of the development of these new technologies.

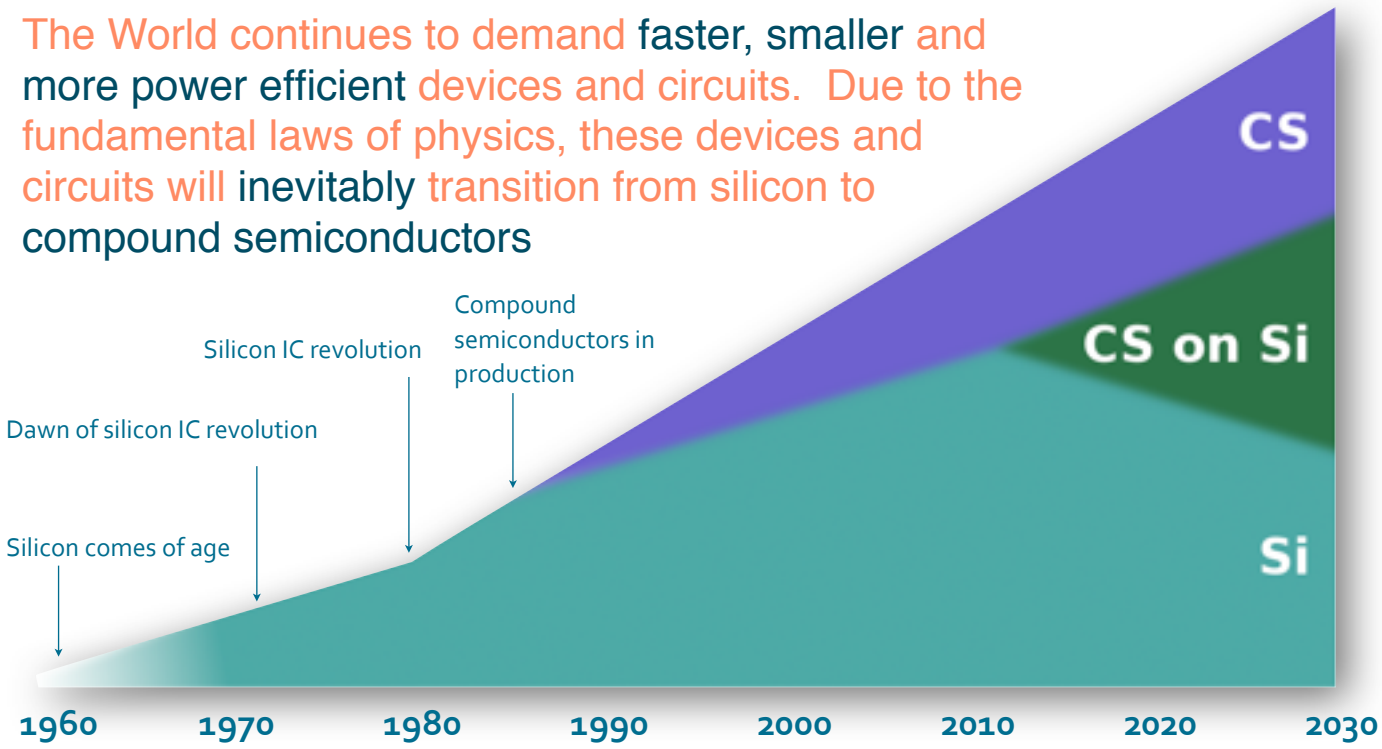
I am proud to be part of a company that lies at the heart of the technology that has, and will continue, to transform the way we live our lives. As you can tell, it is clear to me that we have superb opportunities ahead, with the ambitions, commitment and drive to match.

You will read more in this annual report about the highs and lows of the past year. A tough start to the year, as we grappled with the tail end of a de-stocking by a few major customers, was accompanied by three hugely important strategic transactions which have significantly strengthened our market and technology leadership. A very strong second half performance followed. But be assured, we do not rest on our laurels. There is much hard work ahead if we are to fulfil our ambitions and potential.

I would like to take this opportunity to thank everyone who makes our business successful. To you, our shareholders, thank you for your continued support.

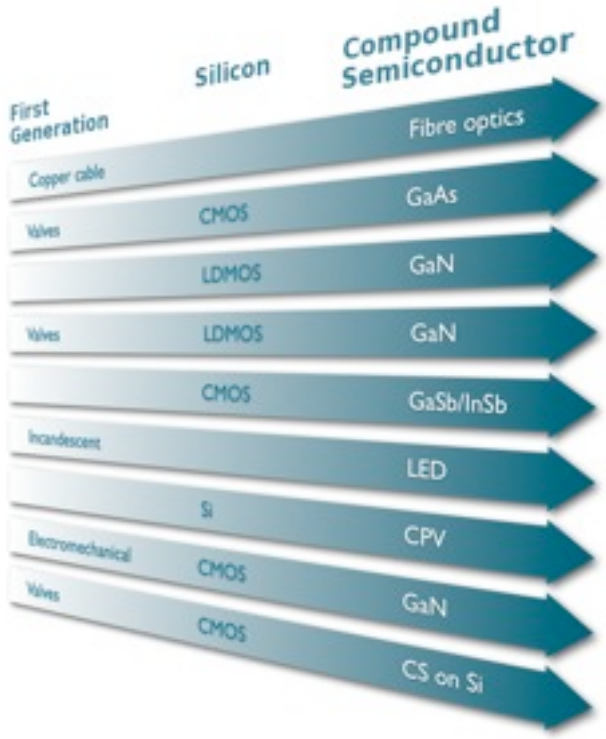
I also extend my sincere appreciation to our dedicated management and staff around the world and across all of our operations for their passion and devotion to making IQE the world leader that it is today.

The World continues to demand faster, smaller and more power efficient devices and circuits. Due to the fundamental laws of physics, these devices and circuits will inevitably transition from silicon to compound semiconductors



"The next quantum leap in technology will be achieved by combining the advanced properties of compound semiconductors with the scale and cost advantages of the mature silicon industry"

Fixed line comms
Cellular handsets
Base stations
Radar
Infrared sensing
Lighting
Photovoltaics
Switching
Computing



"Compound III-V transistors could begin to replace traditional silicon technology around 2015"

Senior Intel Executive

The evolution of semiconductors

The importance of materials throughout history

From the stone age, iron age, and bronze age, through to the industrial revolution, the space race, the electronics revolution and the digital revolution, the evolution of mankind has been enabled by innovations in material science.

The elements

Every material in the universe is made from one or more of the fundamental elements. It is the properties of these elements which has enabled the evolution of mankind. There are 118 elements of which around 100 are naturally occurring. These are recorded in the periodic table where they are arranged in groups according to their properties.

The evolution of semiconductors

Semiconductors are a remarkable combination of elements that have the ability to both conduct and insulate electric current. It is these phenomena that have enabled the electronics revolution that has transformed our lives from the early 1960s through to the present day.

Silicon has been the backbone of the electronics revolution from the 1960s by virtue of the continuous miniaturization of the electronic circuits. This concept, which was expressed by one of the founders of Intel, Gordon Moore, has become known as "Moore's Law".

Impressive as the impact of silicon has been on our lives, it has very basic properties in the context of the broader family of semiconducting materials. This is why human innovation has turned to the advanced properties of other semiconducting compounds to enable the dawn of the digital revolution. It's mankind's ability to harness the advanced properties of the full range of semiconducting materials that will drive the digital revolution for generations to come. This is the world of advanced or "compound" semiconductors.

The early years of compound semiconductors

Whether you realise it or not, compound semiconductors have already revolutionised your life.

The early markets for compound semiconductors have been in laser, LED, and wireless applications. In other words, the advent of the internet, fibre optic communication and the smartphone revolution have been fundamentally dependent on compound semiconductor technologies.

The years ahead

The trends are clear, applications begin their lives based on silicon technology, but inevitably transition to compound semiconductors as human innovation demands more from materials.

But this is only the tip of the iceberg. Compound semiconductor technology will lie at the heart of human innovation for generations to come. We are at an exciting inflection point, and at a time when the rate of change has never been quicker and continues to gather pace.

"IQE is uniquely positioned to enable an exploit this opportunity by virtue of its unparalleled breadth of compound semiconductor technologies and its advanced silicon technologies."

The next quantum leap

Of course, the mass adoption of new technologies is more than just a function of what is possible.

Rather, it is a function of cost versus performance.

Compound semiconductors will continue to gather momentum in their own right as the industry continues to increase scale which is enabling technology to advance and costs to reduce.

But, the next quantum leap in technology will be achieved by combining the advanced properties of compound semi-conductors with the scale and cost advantages of the mature silicon industry.

IQE is uniquely positioned to both enable and exploit this opportunity by virtue of its unparalleled breadth of compound semi-conductor technologies and its advanced silicon technologies.

This is why we are the technology partner for governments and "Blue Chips" alike in developing "compound semiconductors on Silicon."

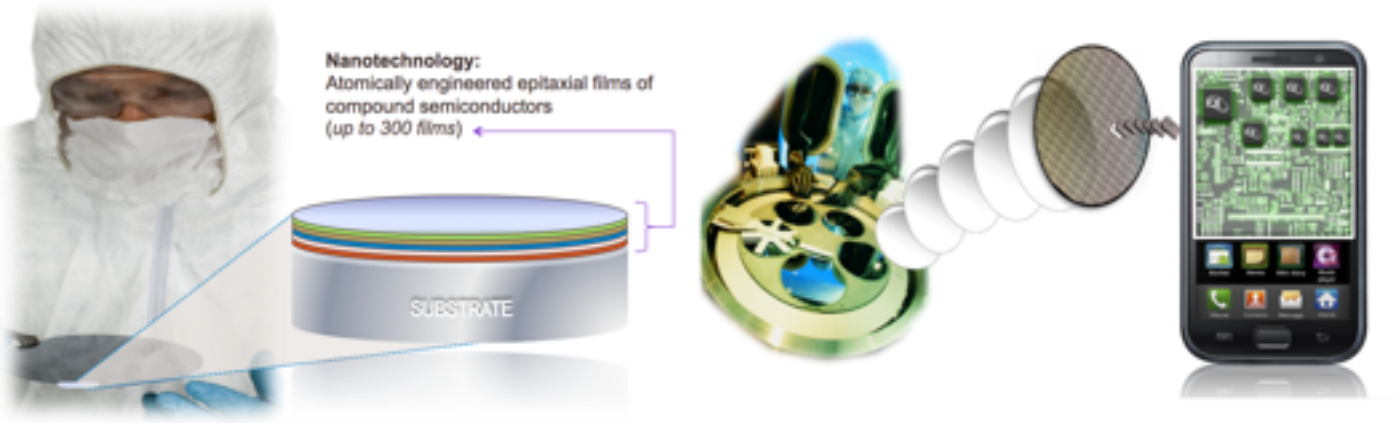
1988

2008: Voice
Silicon based technology

2013: Voice, data, email, internet, video streaming ...
Compound semiconductor enabled technology

enabling advanced wireless, photonic and electronic technologies since 1988

What we do



The supply chain

IQE designs and manufactures advanced semiconductor materials. Our finished products are compound semiconductor wafers (also called "epiwafers").

Our products are bespoke. We manufacture to the exact technical specifications required by our customers.

Our customers fabricate our wafers into the "chips" that form the critical components for a wide range of wireless communication and photonic devices.

Our core IP is "Epitaxy"

IQE manufactures epiwafers using a nano technology called "Epitaxy".

Epitaxy is a form of atomic engineering that requires high specification cleanrooms, sophisticated production tools and high levels of intellectual property.

Essentially, we grow atomically thin films of crystals on a substrate. The substrate is simply a physical and electric template required in order to handle our finished product. It's the combination of layers produced by IQE that gives the epiwafer its properties. The films are grown atomic layer by atomic layer.

Epitaxy is the key enabling technology necessary for the efficient manufacture of compound semiconductors

IQE:
Materials specialists

We make advanced semiconductor wafers in high spec cleanrooms using sophisticated tools and extensive IP

Our customers:
Chip specialists

Our customers fabricate our wafers into chips

OEMs:
System specialists

OEMs utilise these chips to make devices and systems

Our vision

To be the global number one provider of advanced semiconductor materials.

Our strategy

To use technology leadership and scale to deliver the performance, cost points and security of supply required for mass market adoption of compound semiconductor materials.

Our delivery

Number one provider to the wireless market by market share and scale.

Clear technology leader with an unparalleled breadth of technology. Leading the advancement of new materials technologies.

Our competitive advantage

Global footprint

IQE's operations span the US, Asia and Europe. This allows IQE to be positioned close to its customers and build strong relationships.

Breadth of technology

As one of the pioneers of compound semiconductor technology, IQE has developed an unparalleled and comprehensive breadth of technology and advanced production platforms.

Technology leadership

Through organic development and through acquisition, IQE has established clear technology leadership and created a virtuous circle which continues to attract the brightest and best talent.

Cost leadership

In the electronics industry, cost leadership is achieved through advanced technology and scale. IQE has developed leadership in both.

Security of supply

Confidence in a secure supply is critical to the supply chains in which IQE operates. IQE offers its customers identical supply from multiple locations for all its core technologies, allowing it to be a primary and trusted supplier to its customers.

Our risk mitigation strategy

IQE's strategy is to be the most significant supplier to all of the major wireless chip companies in order to mitigate against the impact of swings in market share between the chip companies.

The completion of the acquisitions of the former RFMD and Kopin epi businesses in June 2012 and January 2013 mark the delivery of this strategy.

IQE's unique sales proposition provides differentiation and competitive advantage

Global **leader**
global **presence**

North America	Europe	Asia
Bethlehem, PA	Bath, UK	Singapore
Greensboro, NC	Cardiff, UK	Taiwan
Somerset, NJ	Cardiff, UK	
Spokane, WA	Milton Keynes, UK	
Taunton, MA		

Recent acquisitions

Solar Junction investment and exclusive supply agreement

In February 2012, IQE announced an investment in, and an exclusive wafer supply agreement with leading edge Concentrated PhotoVoltaic (CPV) cell developer and manufacturer Solar Junction Corporation. The investment significantly accelerated IQE's strategy to become a leading global supplier of CPV wafers for the solar power markets.

The deal confirmed IQE as Solar Junction's strategic and exclusive epitaxy partner, a move that has enabled Solar Junction to benefit from IQE's strong materials intellectual property and expertise in high volume epi wafer manufacturing. In turn, IQE secured a partnership for developing CPV technology with Solar Junction with exclusive access to the company's on-going extensive R&D programme. Following the deal, IQE owns a 9% share of Solar Junction Corporation.

RF Micro Devices epitaxy division acquisition and exclusive supply agreement

In June 2012, IQE acquired the entire in-house Molecular Beam Epitaxy (MBE) epi-wafer manufacturing unit of RF Micro Devices, a global leader in the design and manufacture of high performance RF components and compound semiconductor technologies. The deal also included a long-term wafer supply agreement for exclusive provision of all of RFMD's MBE wafers and for provision of a majority of RFMD's Metal Organic Chemical Vapour Deposition (MOCVD) wafer requirements.

The acquisition included a fully furnished epi manufacturing plant, including a fully fitted clean room of over 90,000 sq.ft, 16 MBE manufacturing systems and equipment, all housed in a 135,000 sq.ft. stand-alone building in Greensboro, North Carolina. The 16 operational MBE tools will be partly deployed towards servicing anticipated future CPV solar demand, creating a powerful position in CPV market growth

The deal involved no cash outlay for the transfer of the assets, resulting in no IQE shareholder dilution. In exchange for the transfer of the assets, the parties agreed to a long term wafer supply agreement with a minimum purchase commitment of $55m over the first two years, whereby IQE will supply all MBE wafer requirements and a majority of RFMD's MOCVD wafer requirements under a discounted pricing arrangement.

Kopin acquisition

Post year-end, in January 2013, IQE acquired the compound semiconductor epiwafer manufacturing business of Kopin Corporation for total consideration of $75 million in cash.

The acquired wireless division is the leading global manufacturer of heterojunction bipolar transistor (HBT) materials that are used in power amplifiers, a key wireless component in mobile devices. These are produced using MOCVD epitaxial wafer technology.

The acquisition of Kopin builds on IQE's strategic developments in 2012 to further extend IQE's leadership in wireless industry supply and deliver a market leading position in MOCVD HBTs.

The transaction also builds on IQE's risk mitigation strategy and market share in wireless, adding Skyworks as a major customer and increasing IQE's wireless market share. Skyworks' current contract with Kopin Wireless runs until the end of 2013 and guarantees a significant proportion of Skyworks' business.

Additionally, the move extends IQE's global manufacturing footprint with the addition of a Taiwan manufacturing facility, providing a strong position to access the growing Asian semiconductor market.

Scottish economist Adam Smith (1776) advocated **specialisation** as a **competitive advantage**

Our business model

Outsourcing pioneer

In the early days of the industrial revolution it became absolutely necessary for manufacturers to be vertically integrated since there were no alternative sources of specialised goods and services.

Only towards the middle of the twentieth century did specialisation become a competitive advantage.

However, in new and emerging technologies, the early adopters were in a similar position to their industrial revolution forefathers in that the development of new processes and technologies required the early pioneers to establish all key parts of their supply chain.

Specialisation within the silicon industry

Early silicon chip manufacturers found it necessary to set up complete vertically integrated supply chains to source each part of the production process from raw materials through to final packaged product.

As silicon technology matured, the industry saw the emergence of businesses specialising in different parts of the process to the extent that there now exist a large number of fabless companies who outsource the entire production process to large specialists such as *TSMC Ltd* and *Global Foundries*.

Pioneering specialisation within the compound semiconductor industry

The compound semiconductor industry shares similar attributes with the silicon chip industry. Some of the processes such as epitaxy require large scale investment, complex infrastructure support in the form of cleanrooms, environmental controls and most importantly, highly specialised skills and expertise.

In 1988, IQE became the first compound semiconductor materials company to recognise the potential value in offering specialised outsourcing of compound semiconductor wafers and has witnessed an increasing trend towards this model over its twenty-five year history.

Our track record

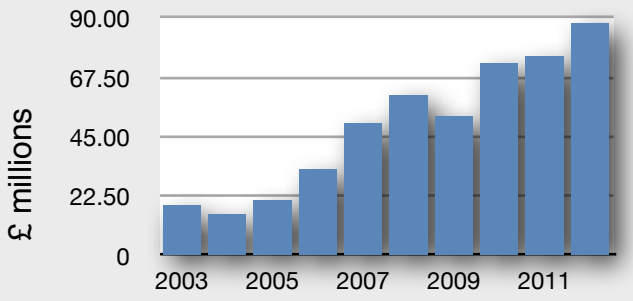
- *Sales CAGR of 25% over 5 years*
- *High operational gearing to transform profitability*
- *Operational and financial resilience*
- *Strong position in high-growth markets provide strong outlook*

By specialising in the complex epitaxy process, IQE offers its customers economies of scale, access to leading technology and the ability to do what they do best: design and refine their products.

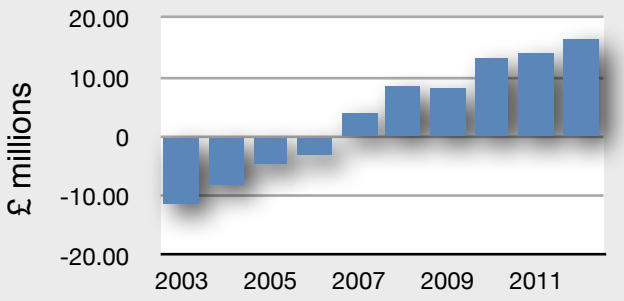
The high level of investment means that IQE's business is highly operationally geared which facilitates significant scope for profitability once sales contribution exceed fixed costs.

The last decade has demonstrated an unprecedented number of key industry suppliers selecting outsourcing as a key business advantage.

Revenues 2003 - 2012



EBITDA 2003 - 2012



Adoption of compound semiconductors driven by several "megatrends"

	Wireless	Photonics	Electronics
High speed connectivity	Smartphones tablets, WiFi Infrastructure Satellite 	Active optical cables Optical comms Thunderbolt 	Advanced silicon SiGe, GaN on Si CS on Si 
Energy efficiency	Power efficient infrastructure Smart meters 	CPV Solar energy LED lighting 	GaN power control Electric vehicles Power switching 
Lifestyle	Social networking Home automation 	Leisure and gaming Cosmetic Health 	Leisure and gaming High capacity memory High speed processing 
Safety & security	Radar Airport security RF communications 	Laser guidance Night vision Infrared CCTV 	Missile detection Guidance systems 

Our markets

Overview

The key advantages of compound semiconductors over silicon are :

Compound semiconductors are much more efficient at emitting and receiving radio waves

Compound semiconductors are much more efficient at emitting and detecting light

Compound semiconductors operate at much higher speeds and lower power consumption

It is these advanced properties which determine the markets for our materials:

- Wireless
- Photonics
- Electronics

Wireless

Accounts for 79% of the group's sales in 2012.

The wireless market covers electronic devices that communicate wirelessly.

This includes but is not limited to mobile phones, smartphones, mobile networks, WiFi, smart metering, satellite navigation, and a plethora of connected devices.

Photonics

Accounts for 20% of the group's sales in 2012.

The photonics market covers applications that either emit or detect light.

We segment the photonics market into:

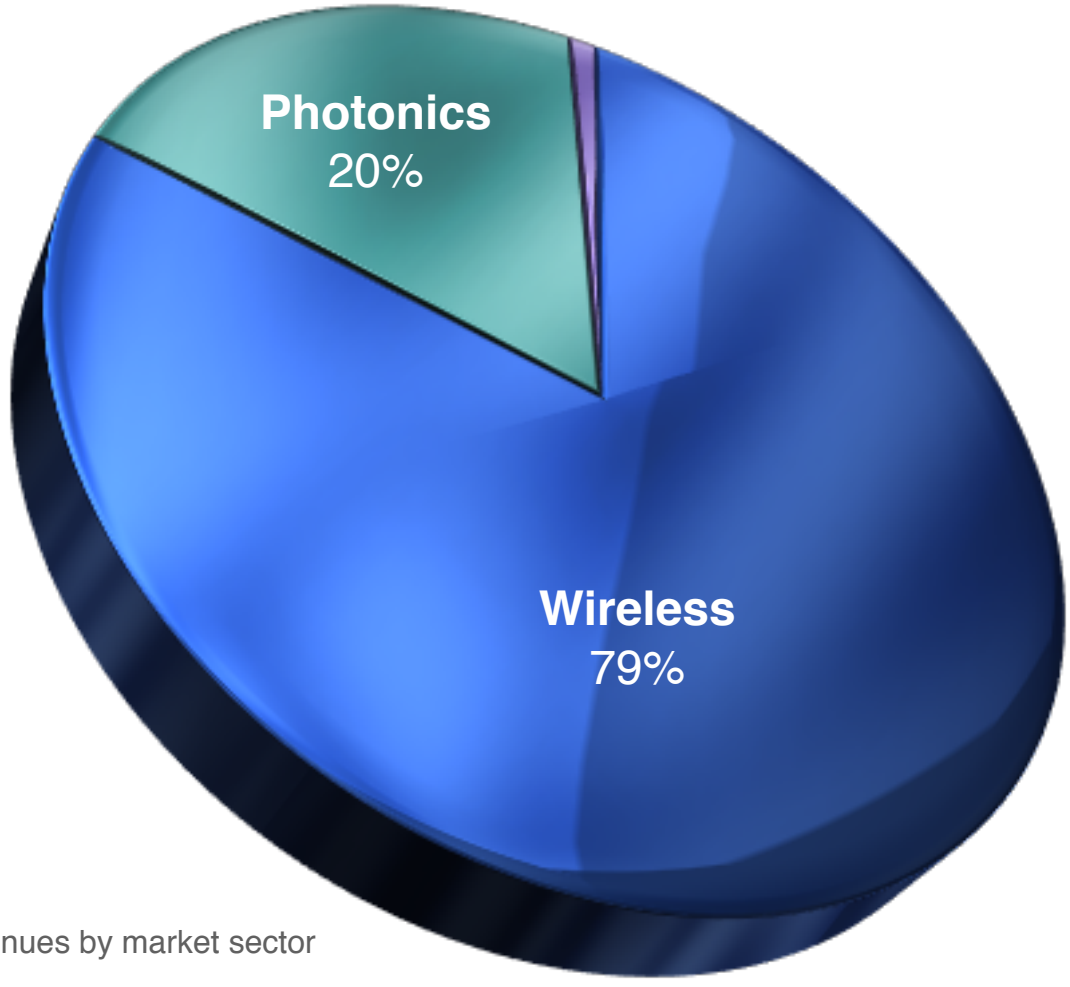
- Emitters and detectors
- Infrared
- Solar (CPV)
- Lighting

Electronics

The electronics market combines the advanced properties of compound semiconductors with the low cost of silicon.

We segment the electronics market into:

- Power control
- Advanced materials



IQE's 2012 revenues by market sector

Wireless

The wireless communications market has grown rapidly in recent years reflecting the increasing adoption of wireless technology, coupled with the need for a increased compound semiconductor content to support greater sophistication of mobile devices.

More than 1.75 billion mobile handsets were sold in 2012, of which over 670 million were smartphones that carry significantly more compound semiconductor materials.

Smartphone shipments are expected to show further growth in the coming years, driven by new features, apps, social networking, entertainment and location based services.

High-speed connectivity and added functionality drive the requirement for the advanced properties offered by compound semiconductor epiwafers. The global roll-out of wireless broadband networks such as 4G/LTE devices increasingly rely on higher levels of compound semiconductor content.

Shipments of smartphone devices represented 38% of total handset shipments in 2012 compared with 32% in 2011.

Globally, smartphone penetration is estimated to represent only 18% of the total handset market in terms of subscribers, indicating significant growth potential.

Future drivers for smartphone sales include near field communications for contactless payments, and augmented reality for enhanced location based services.

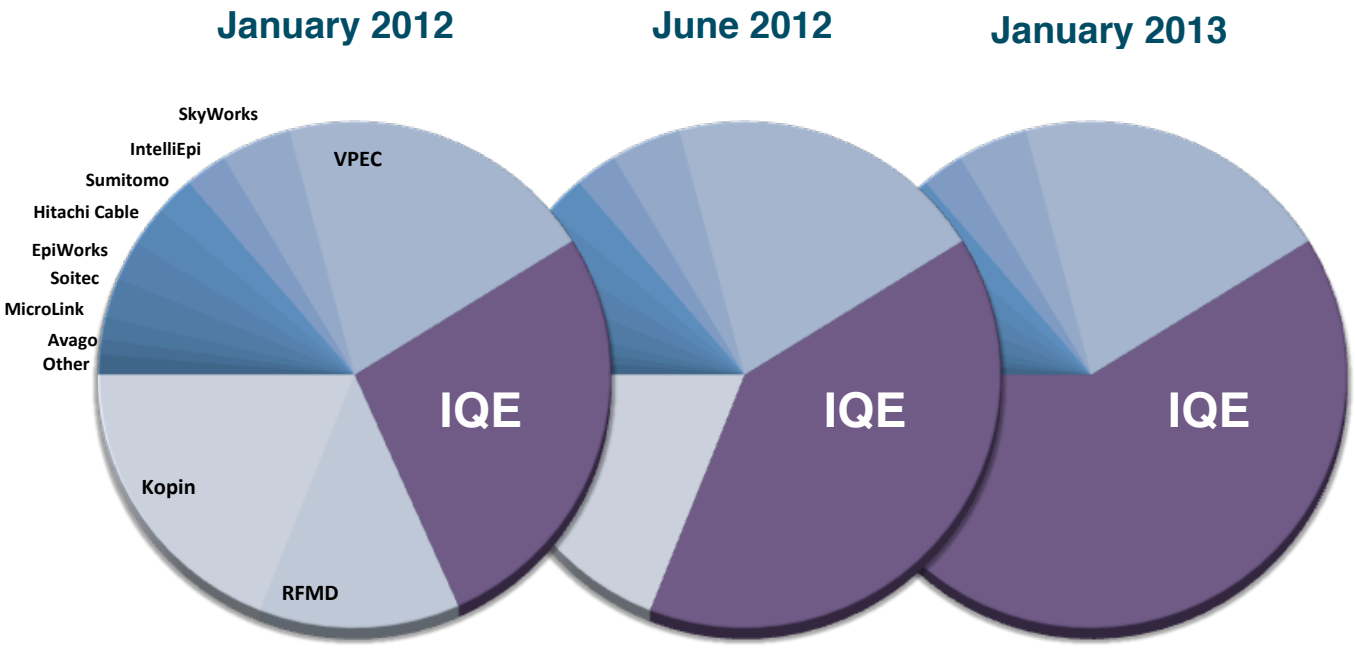
The migration to new WiFi standards is another major driver for RF components.

2012: total year on year handset shipments declined 1.75% to 1.75b units. smartphone shipments increased 42% to 671m units during the same period

The new 802.11ac WiFi standard will operate at 5GHz rather than the 2.6GHz currently used. The higher frequency which will greatly increase the range and reliability of WiFi networks, will further raise the demand for compound semiconductor based RF devices.

Wireless chip companies are expected to show around 15% CAGR over the coming years.

This growth will be driven by the need for more radio frequency functionality and greater complexity in wireless circuitry but will be partly mitigated by improved efficiencies and a drive towards reduced component footprints.



IQE's change in wireless market share change since January 2012

The wireless communications market continues to represent an exciting long term growth prospect for IQE due to:

- ***Continuing strong market growth for mobile devices***
- ***Increased compound semiconductor content***
- ***Adoption of higher specification WiFi networks***

Photonics

Photonics represents applications which emit and detect light. We segment this market into emitters and detectors, infra-red, solar and lighting.

Emitters and detectors

This encompasses a wide range of applications including optical interconnects, laser projectors, optical storage, cosmetic applications, gesture recognition and finger navigation.

Optical interconnects

Higher data transfer rates demanded within data centres as well as consumer applications such as high-definition imaging and video streaming, require high-speed data transfer rates for faster communications between devices.

Optical interconnects offer significantly higher-speed data transfers over much longer distances than their copper counterparts and are certain to replace existing cable standards such as USB and HDMI, as these traditional cables struggle to meet the increasing demands for data transfer.

This is a mass market opportunity, where demand for USB cables alone is around three billion units a year.

Compound semiconductor technology that enables optical interconnects include Vertical Cavity Surface Emitting Lasers (VCSELs).

VCSELs are an advanced laser technology geared to mass production and low cost.

IQE is the market and technology leader for VCSEL products, with world record data speeds in excess of 40GBs already demonstrated.

Laser projectors

Conventional projection technologies utilise incandescent or halogen lamps as their light sources. Such devices are power hungry, physically bulky, have relatively short lifetimes and require focusing optics which can limit the image quality and flexibility.

The emergence of lasers in each of the primary colours (red, green and blue) enables a low cost, high quality laser projection solution which can be miniaturized and does not require focusing optics. This technology is called pico projection.

Early pico projector technologies utilise LEDs for the light source but the next generation of devices will incorporate miniature laser projection units.

High speed, high density optical storage

The commercialization of IQE's gallium nitride (GaN) photonic technology will also provide the Group with access to the rapidly growing market for high-speed, high-density optical storage (Blu-ray). Industry analysts predict growth rates in this market of c. 55-60%.

Cosmetic applications

There are exciting new applications of compound semiconductor technology in the billion dollar cosmetics market. We are working with a number of customers to develop advanced laser technology for cosmetic applications such as laser hair removal, wrinkle treatment, skin rejuvenation, acne and psoriasis treatments to name just a few.

Gesture recognition

Gesture recognition represents the ability of electronic devices to recognise hand and body gestures and movements in order to control any device. The advanced properties of compound semiconductor epiwafers are a key component in gesture recognition devices which made their debut with the launch of Microsoft's Kinect gaming console.

The potential applications for this technology extend far become gaming, from medical applications, disability aids, remote controls, to sign language recognition, and more. In fact, the use of this technology is only limited by human imagination, and has far reaching implications for how we will interface with technology in the near future.

Finger navigation

Finger navigation is closely coupled with gesture recognition in terms of how humans will interface with machines in the future. After their emergence via RIM's Blackberry devices, the use of lasers and optical sensors for precise control of miniature track-pads is also likely to penetrate areas such as remote control units, cameras and other consumer devices over the coming years.

Infrared (sensors)

IQE is the clear market leader in advanced gallium antimonide and indium antimonide substrates for use in a range of infrared and heat sensing applications.

The sensitivity of current heat sensors enable a monochrome image so that applications such as night vision devices can only see in tones of green and black, whereas the new antimonide materials allow greater sensitivity so that different shades and colours can be distinguished, effectively producing full colour night vision images.

The improved sensitivity is useful for search and rescue operations and the full colour night vision capability has major military potential in terms of enabling effective identification of personnel and equipment in low or zero visibility conditions.

IQE is actively engaged in a number of collaborative programmes along with leading industry players and government agencies in the development and supply of infrared materials based on antimonide materials.

Solar (CPV)

Solar cells utilising compound semiconductors (called CPV or Concentrated PhotoVoltaics) provide the most efficient solution by using multiple layers of finely tuned materials to absorb sunlight across a wider range of wavelengths.

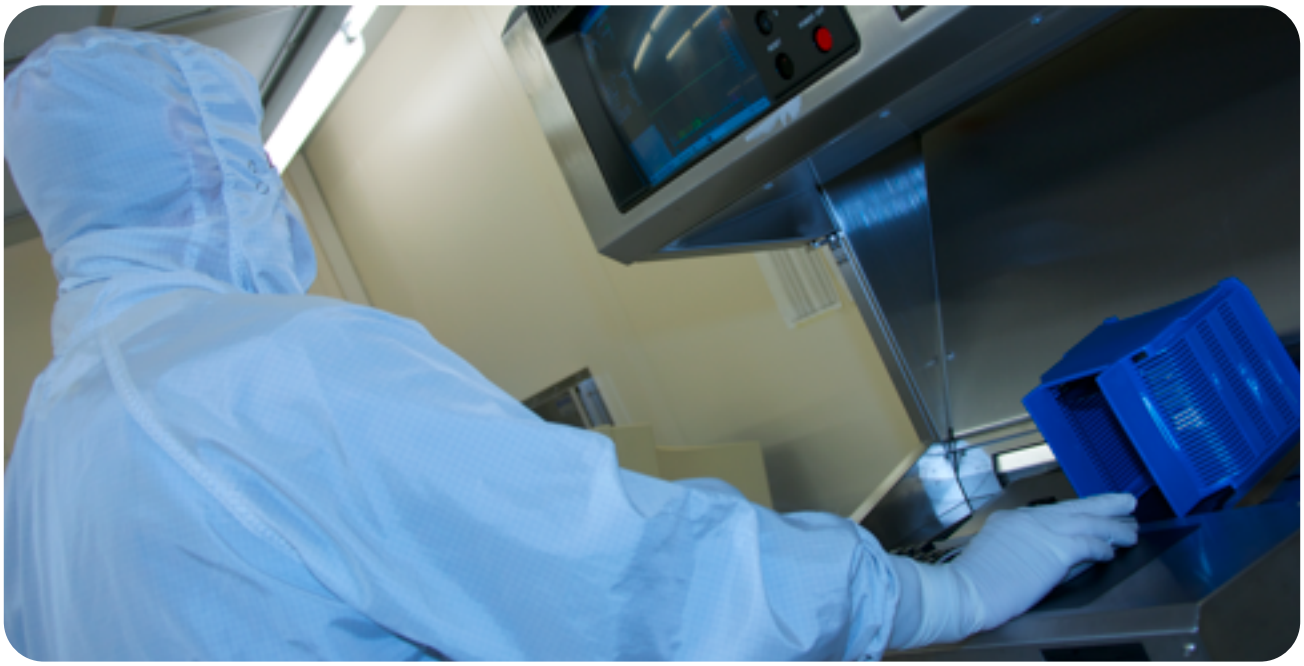
As a result the efficiency of this material is already in excess of 44%, with a roadmap to increase this to beyond 50%.

This compares with 12 to 18% efficiency from silicon solar panels, while thin film technology is typically around 10 to 15% efficient. There is very little scope to improve the efficiency of these technologies due to the fundamental properties of the materials used.

A further advantage of compound semiconductors is their tolerance of higher temperatures. This means the cost of CPV systems is also reduced by using lenses which intensify sunlight and thereby reduce the amount of semiconductor required.

CPV has now reached price parity with fossil fuels and other alternative energy sources in high sunlight regions and is considered to be at an inflection point, with industry analysts forecasting 175% compound annual growth rates for CPV installations, which are expected to grow to over 1.0GW of generating capacity by 2015, representing an epiwafer market opportunity of over $200m.

Early in 2012, IQE announced a strategic investment in Solar Junction Corporation, a US based CPV manufacturer with some key intellectual property. Solar Junction Corporation holds the world record for solar cell efficiency at 44.5%. IQE's investment in Solar Junction also gives the Group exclusive long-term manufacturing rights over its IP, which includes a technology roadmap to design solar cells with efficiencies in excess of 50%.



Solid state lighting (LEDs)

A high performance, low cost, green alternative to incandescent light bulbs.

Global concerns about climate change and the Earth's dwindling natural resources continues to be a priority for governments worldwide. Significant new policies and legislation continue to be introduced in the direction of renewable and highly efficient energy devices.

Already, many continents have introduced wide-ranging legislation to progressively ban incandescent lighting with 2012 being a key milestone for eradicating the form of lighting altogether. Alternative low energy lighting is unpopular because of perceptions of low quality lighting and on-going issues with heavy metal content including mercury.

Solid state lighting is widely viewed as the only credible solution to replace the incandescent light bulb. Efficient energy consumption will remain a key driver in the development and adoption of this technology, but the critical success factor is reducing cost and improving the ambience of these units.

High quality gallium nitride provides the route map to achieving this, which will revolutionise residential and commercial lighting around the planet over the coming years.

Solid state lighting is widely viewed as the only credible solution to replace the incandescent light bulb.

High quality gallium nitride provides the route map to achieving this.

Electronics

Power control

Gallium nitride (GaN) is a compound semiconductor that offers a diverse range of RF, photonic and electronic properties.

Of particular interest is the material's ability to cope with high voltages, high temperative, and high power which makes it an ideal candidate for power control systems which are growing in demand driven by alternative energy sources such as solar, wind and wave power, and also the adoption of electrically driven transportation.

It is estimated that more than 10% of all electricity is ultimately lost due to conversion inefficiencies, as energy is switched from generation, to grid, and through to consumption. The scale of this loss exceeds the world's entire supply of renewable energy generation.

The transformers that we use for our electronic devices, such as laptop power supplies, provide a vivid example of this phenomenon by the virtue of the heat energy they generate as electricity is lost.

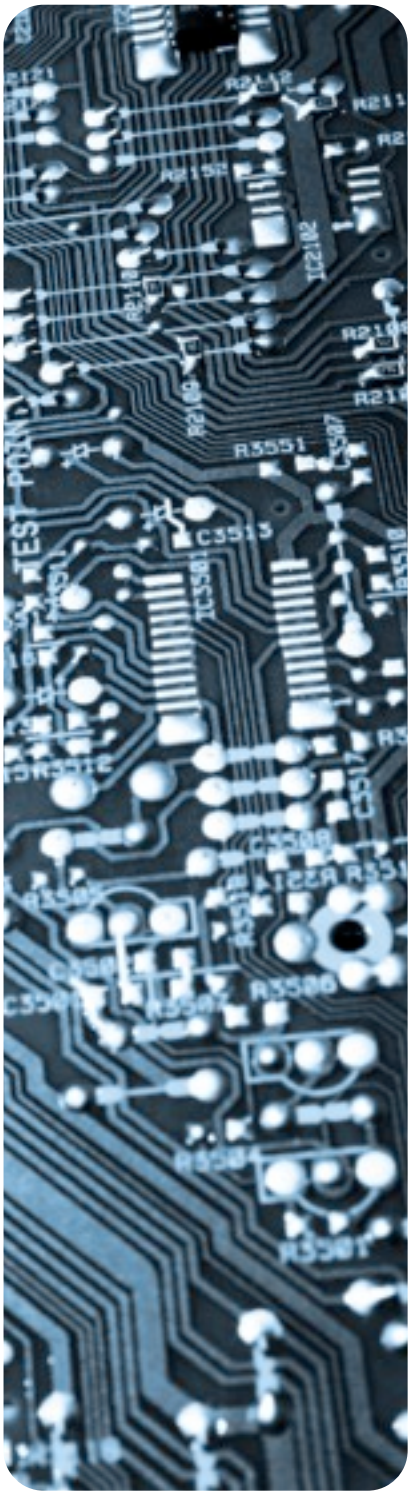
GaN offers performance and efficiency which are orders of magnitude better than the silicon technology which dominates power switching technology today. Indeed, this technology has the potential to eliminate up to 90% the energy lost through switching.

Advanced materials

IQE has developed a powerful range of advanced, engineered wafers such as germanium-on-insulator (GeOI), germanium-on-silicon (GeOSi) and silicon-on-sapphire (SOS), which offer a high performance and low cost solution for next generation microprocessors, ultra-high speed/ high density flash memory and MEMS devices such as motion sensors.

IQE has established a powerful position in these advanced technologies, working with some of the biggest names in the industry, which is reflected in a number of joint patents awarded in conjunction with Intel for the production of compound semiconductor materials on silicon substrates.

We believe that the intellectual property that we are developing in this field has the potential to revolutionise the semi-conductor world, and in doing so create significant long term value to IQE stakeholders.



Current trading and outlook

IQE is now the clear technology and market leader in the wireless market, with an estimated 50% to 60% share. The benefit of the three key deals will increasingly be reflected in the Group's performance going forward.

The Group is also beginning to see the rewards of its investment programme in advanced wireless technology over the last two years and in initial production with a number of chip companies on advanced BiHEMT technology.

As anticipated, the Group's photonics (optoelectronics) business is transitioning towards high volume applications. IQE has started to ship advanced VCSEL materials for optical communications applications, including data centre applications. The Group remains on track to transition to production for a range of other applications, including solar power (CPV), in the second half of 2013.

IQE continues to develop new products at the leading edge of technology such as compound semiconductors on silicon integrated circuits, which, in due course will revolutionise the electronics marketplace.

The focus in 2013 is on delivery. IQE will access the significant efficiencies and synergies that the three deals bring to the Group and leveraging the investment in product qualifications in order to deliver strong organic growth in the core markets.

The current financial year has started well, in line with the Board's expectations, with the momentum seen in the second half of 2011 continuing. Overall IQE is well positioned to deliver strong growth in the current year and beyond, based on its premier position to supply of its advanced technologies in growing global markets.

Operational highlights

A secure supply provides competitive advantage

IQE's spare capacity and multi-site supply gives our customers confidence in our ability to meet their growth needs and surges in demand.

This is why IQE embarked on a capacity expansion programme which spanned 2011 and 2012. This programme was successfully concluded on time and budget.

This was further complemented by the spare capacity that came with the acquisitions of the ex RFMD and ex Kopin epi businesses in June 2012 and January 2013.

Process innovation

As part of the group's constant improvement strategy, IQE has demonstrated process innovation to increase production efficiencies, resulting in both throughput and quality improvements. This technology will be rolled out across our customer base over time, providing both capacity and margin benefits.

Equipment upgrades

Maintaining our fleet of high spec production tools at a state-of-the-art standard is a key part of our strategy to push technology boundaries in parallel with achieving cost down targets.

We have made continued progress during 2012 in our programme of tool maintenance and upgrades. We continue to innovate our planned maintenance cycles, and are actively engaged in a tool upgrade programme to maintain our competitive edge.

Integration of acquisitions

IQE's impressive track record has been achieved both organically, and by acquisition.

In doing so, IQE has demonstrated a clear ability to successfully and seamlessly integrate newly acquired businesses into the group.

This was further demonstrated in the second half of 2012, with the successful integration of the epi business acquired from RFMD. Post acquisition this unit has seamlessly and successfully met significant levels of customer demand over and above expectations.

Best practice sharing

The challenge of a successful integration is to "make the whole greater than the sum of the parts", and deliver synergies beyond just the incremental business acquired.

This is where IQE has been particularly successful, with an impressive cross fertilization of technologies, know-how and ideas across the group.

This benefit has been recognized by our customers who see the collaboration of our world leading material scientists as a compelling benefit and competitive advantage of IQE as the technology leader in our industry.

Qualifications

As they say, the "proof of the pudding is in the eating"; and in our industry, the first measure of success is in the qualification of your product with the customer.

The market leadership that IQE has achieved stands as a testament to our operational excellence

This is where IQE has enjoyed excellent progress over the course of the past year.

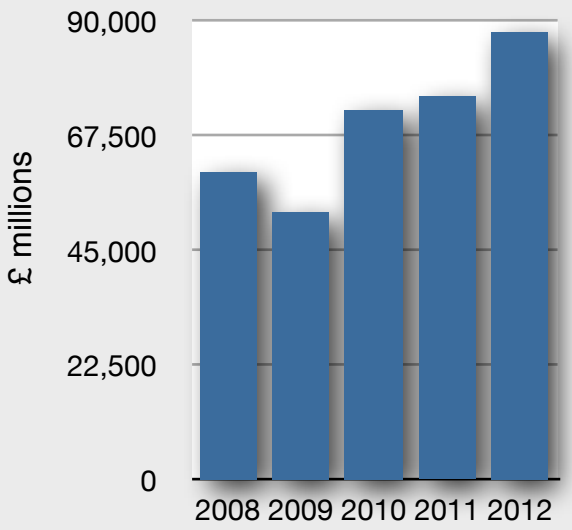
Our success in BiHEMT technology is a particularly good example, where IQE is now qualified and in production with 5 wireless chip companies for this very advanced wireless material. We expect sales of these products to move from strength to strength as the industry seeks to address the increasing demands of 4G communication.

In the opto electronics market we are seeing the transition of several R&D programmes into production, particularly with VCSEL technology and fiber optic communications. Specifically, we are now in production with multiple customers for data centre applications.

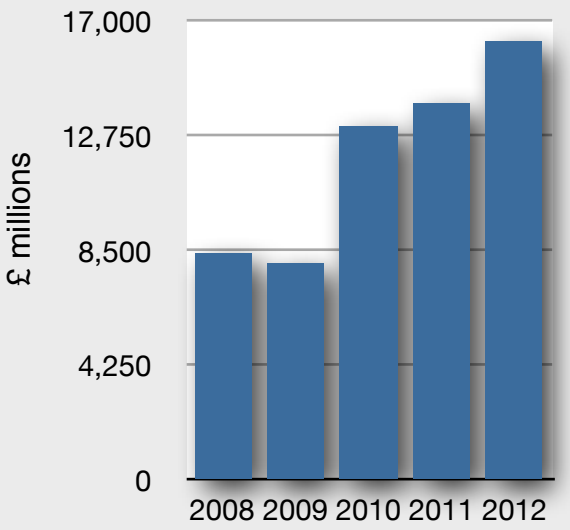
Beyond this, the pipeline remains full with qualifications in progress for multiple new applications including advanced silicon for wireless applications, advanced VCSELs for active optical cables and finger navigation.

Financial highlights

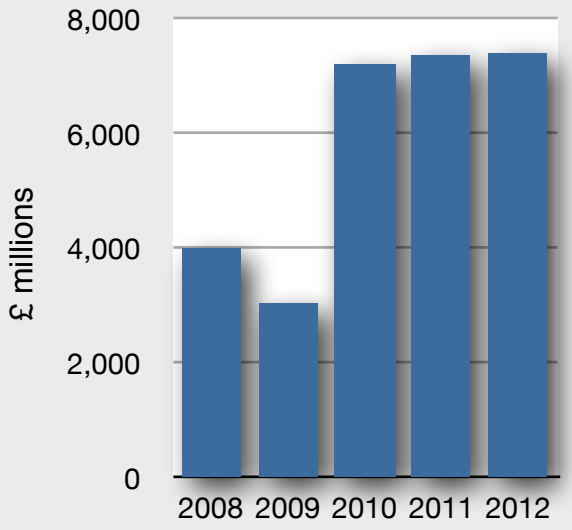
Revenues



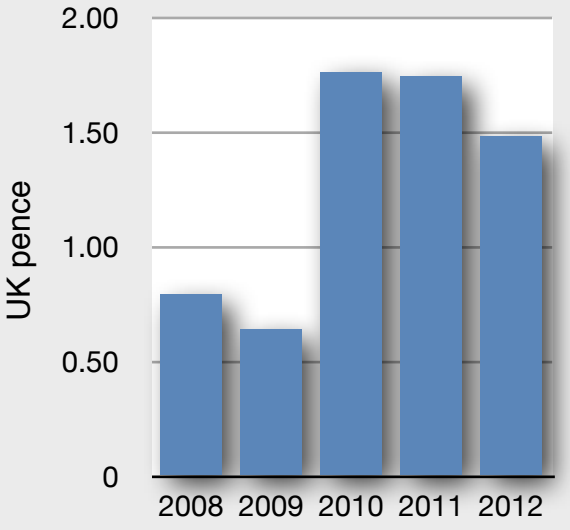
EBITDA



Operating profit
(before exceptional items)



EPS
(diluted and adjusted)



Financial Review

Overview

The Group enjoyed a very strong second half and delivered record full year sales and EBITDA despite the poor first quarter.

Revenues grew 17% year on year from £75.3m to £88.0m driven by increased sales volumes. The acquisition contributed £20m to sales.

EBITDA

Group EBITDA was up 18% to £16.4m (2011: £14.0m).

As anticipated, sales and profits were much more heavily skewed to the second half than normal, reflecting the impact of the destocking in the first quarter and the benefit of the RFMD acquisition on trading in H2. Sales and EBITDA in the second half were £53.7m (2011 H2: £37.0m) and £12.2m (2011 H2: £7.9m) respectively.

Gross profit

Gross profit increased to £18.5m from £18.2m. Whilst contribution margins have remained stable, the benefit of the sales growth has been partly offset by higher depreciation and the overhead associated with the facility acquired from RFMD.

SG&A

Selling, general and administration expenses increased by £0.7m to £11.5m (2011: £10.8m). This increase largely reflects one-off costs of £0.6m related to the three transactions.

Operating profit

Adjusted operating profit, before the one-off £0.6m transaction costs, increased from £7.4m to £7.6m.

Interest

Interest cost of £0.9m (2011: £0.5m) included £0.3m of notional interest relating to the discounting of long term balances arising on acquisition (2011: £nil).

Pre tax profit

Adjusted pre-tax profit was up 5% to £8.6m from £8.2m. Adjusted pretax profit excludes non-cash financing charges relating to discounting of long term acquisition balances (£0.3m), exceptional charges of (£0.6m), charges relating to the amortisation of intangibles arising on acquisition (£0.3m) and share based payments (£1.4m). Reported pretax profit was £6.1m (2011: £6.9m).

Tax credits

The income tax credit of £0.5m was lower than the £1.5m tax credit in 2011, which included a £1.0m non-cash deferred tax credit. Tax receipts of £0.5m in 2012 relate to R&D tax credits (2011: £0.5m). The Group has sufficient tax losses available to shield future tax payable of up to £31.2m.

Earnings per share

Adjusted earnings per share were 1.59p (2011: 1.86p). Basic earnings per share were 1.16p (2011: 1.62p).

Retained profit

Adjusted (see note 9) retained profit was £9.1m (2011: £9.7m), including a £4m contribution from the acquisition. Reported retained profit was £6.6m (2011: 8.4m).

Dividends

The Board will not be recommending the payment of a dividend.

Cash generated

Cash generated from operating activities was £4.8m (2011: £10.3m). Cash generated from operating activities assuming cash settlement of acquisition of £13.2m (see below).

Deferred consideration paid of £7.0m (2011: £1.1m) primarily related to the final balances for the Galaxy acquisition in 2010. In addition, the Group invested £3.2m for a 9% equity stake in Solar Junction.

Capital expenditure

Capital expenditure of £11.6m (2011: £15.5m) marked the completion of a major multi-year capital expansion programme. Capital expenditure will now return to maintenance levels.

Investment & equity

Investment in product development of £4.0m (2011: £3.7m) primarily reflects investment in new products to access new and emerging markets.

Proceeds from new equity issued was £11.4m (2011: £0.6m). This primarily reflects the issue of £10.5m of new equity to finance the investment in Solar Junction and related expenditures.

Debt

Net debt, was in line with the Board's expectations at the end of December 2012 was £15.5m (2011: £3.9m).

Acquisition

See business combination note 17 to the accounts.

Innovation, research and development

R&D activity

The continuous development of leading edge materials technology is paramount to IQE's success. The Group's twenty-five years' experience combined with a culture of innovation has enabled us to develop technology and market leadership in the markets in which we operate.

We continue to push the limits of materials technology, constantly improving the quality of existing products whilst developing new and enhanced capabilities. We are engaged in a number of research and development programmes with customers, research institutions and government agencies.

IQE has many exciting development activities in place to ensure continuing support of our growing customer base and the increasing range of commercially important semiconductor devices.

IQE's development activities include internally-funded, government-funded, customer-funded and third-party co-funded projects.

Development programmes are often associated with next generation applications as well as process improvements leading to greater throughput, higher-quality products, better manufacturing yield, increased production uptime and new product development.

Whilst many R&D programmes are subject to non-disclosure agreements and confidentiality, there are some programmes in the public domain, examples of which include:

- Integration of III-V with Si
- Graphene for RF electronics
- Sb-based materials
- QD VCSELs (EU VISIT program)
- Dilute nitrides for lasers and SWIR detectors
- Mixed nitride-antimonide-based detectors
- High power InP-based quantum cascade lasers

A list of technical publications is available within the research pages of the IQE website at www.iqep.com.

Open Innovation

In recognition of IQE's reputation for quality, innovation, research and development, the Group's corporate headquarters in Cardiff, UK, has been selected by the Welsh Government to head up an Open Innovation initiative to collaborate with industry and academia to identify supply chain opportunities within Wales and across Europe.

Industry events

IQE actively participates in major industry events and frequently chairs, hosts and presents technical papers at international conferences.

Government

IQE's products form the essential key enabling technologies (KETs) whose impact cuts across world leading industries including the automotive, chemicals, aeronautics, space, health and energy sectors

Many governments worldwide have recognised the importance of KETs in driving economic growth.

The importance of KETs is such that they will form a significant focus for government funded programmes over the coming years.

IQE maintains good relationships with many government agencies and departments across geographies in which it operates.

IQE is widely recognised by government departments and agencies as world experts in advanced materials and representatives from the company are often called upon to provide input and advise on areas of technology in which the group has acknowledged and respected expertise.

Our commitment

Corporate social responsibility

The IQE Group actively promotes a philosophy of corporate social responsibility across all of its operations and engages in a number of local, national and international initiatives working with a wide range of third party organisations and authorities in areas such as ethical employment policies, educational and community work.

Every effort will be made by all Group companies to ensure best business practice is deployed by:

Respecting the need for confidentiality across our global customer base by ensuring that any references to customer's names, products or services are not disclosed to third parties without the customer's consent;

Being open and honest about our products and services and communicating with customers all appropriate information they need to make informed decisions;

Ensuring that any issues or problems are dealt with efficiently, with fairness and in a timely manner;

Working closely with customers and potential customers to help us improve the value of the products and services we offer them;

Ensuring that we benchmark and evaluate what we do in order to constantly improve products and services in the marketplace;

Communicating with all stakeholders as and when appropriate, effectively and transparently subject to ensuring confidential information is not compromised;

Identifying and selecting suppliers using fair and reasonable methodologies;

Identifying and using suppliers who operate to ethical business standards;

Identifying and using local suppliers wherever possible;

Working closely with suppliers to help us improve the value of the products and services we offer customers to the benefit of the supply chain;

Ensuring that our terms and conditions are fair and reasonable;

Ensuring employment practices throughout the Group are fair and in full compliance with employment legislation;

Working with and supporting local and national charities;

Encouraging volunteer work in community activities;

Supporting local academic establishments; and

Participating in voluntary business advisory services via professional bodies.

Each of the Group's subsidiaries is responsible for communicating and applying group policies within their businesses taking account of local legislation and potential risks.

The group also actively engages with a number of industry groups, educational bodies and charities to promote science and technology and to help contribute to community causes.

Each of the Group's subsidiaries is responsible for communicating and applying group policies within their businesses taking account of local legislation and potential risks.

As an AIM listed company, IQE is not eligible to participate in the London Stock Exchange FTSE4Good programme, but nevertheless maintains standards and applies the principles of this index. The group also actively engages with a number of industry groups, educational bodies and charities to promote science and technology and to help contribute to community causes.

Quality

IQE's reputation for quality and excellence in products and service is second to none. A philosophy of total quality is integrated throughout the group's operations and each of the group's manufacturing facilities worldwide is independently accredited to the international standard for Quality Management: ISO9001:2008.

IQE's ongoing commitment to provide the highest quality of service ensures customer satisfaction covering the entire customer relationship experience, from order inception through to delivery and after-sales support.

IQE's quality assurance program includes wafer evaluation using the most advanced measurement techniques applied specifically to its customers' structures, thereby ensuring consistent delivery of the highest-quality products. Rigorous data logging and documentation of all manufacturing processes and procedures maintain a system of full product traceability. IQE's thorough materials characterization processes ensure excellent repeatability and reproducibility.

Customers strongly value the trust and confidence they have established with IQE as a "pure play" supplier with whom they share their most confidential and proprietary device design information. The IQE strategy is to consolidate and maintain its position as the pre-eminent supplier of epiwafers rather than vertically integrate into device or component manufacturing. This philosophy protects customer interests to the fullest and facilitates excellent supply chain relationships.

Employing its extensive wafer production experience, IQE continually maintains its technological leadership through the development and implementation of new growth and characterization technologies and new materials solutions. IQE is actively involved in partnerships with its suppliers of crystal growth and characterization equipment to develop the next generations of epitaxy and metrology equipment with specific focus on increasing production efficiencies, reducing epiwafer costs, and maintaining its technological leadership.

The environment

IQE is fully committed to creating business growth whilst ensuring that the impact on the environment is minimised and that all activities are conducted safely by appropriately trained and qualified employees. The group works closely with all key stakeholders to ensure that its global facilities, and those activities over which it has influence through its supply chain, operate in a way that is ethical and in accordance with best practice.

Policies relating to quality and environmental standards are available on the company's website at www.iqep.com along with access to third party accreditation certificates.

Risks and risk management

Raw materials

The primary raw materials used in IQE's processes are not scarce and are in general sourced from multiple continents.

In some cases, materials may have uses in multiple industries and as such, may be prone to temporary fluctuations in supply and demand where there are surges in usage.

One such example is Indium which is in relatively abundant supply. Indium is used in small quantities in the manufacture of flat panel displays. A sudden surge in demand for flat panels had a short term impact on global indium pricing but such impacts are normally short-lived and their affect on IQE usually negligible.

Natural disasters

IQE operates multiple global manufacturing facilities which customers see as key mitigation against the impact of natural disasters.

However, the impact of such disasters on other parts of the supply chain cannot be ruled out but such macro-economic factors would have a much wider impact on the global economy.

Supply chain risk mitigation

IQE supplies many different customers with a diverse range of products.

The wireless sector accounts for approximately 80% of the Group's revenues. Within this space there are approximately twelve key customers who in turn supply all of the key wireless device manufacturers.

IQE supplies each customer with up to three different products which are then further sub-divided into several different part numbers, each with different specifications. The numbers and types of products varies over time as new products are launched and older lines become obsolete.

IQE's strategy has to ensure that as many parts and products are embedded with as many customers as possible to reduce the risk of losing a supply socket should a customer lose market share.

This mitigation strategy for wireless products has been significantly enhanced with the major transactions successfully completed since the beginning of 2012.

Process improvements

IQE's strategy is to focus on high-growth technology markets such as the wireless sector where growth in smartphone units sold is accompanied by greater demand for higher performance materials such as those supplied by IQE.

However, this increased demand may to some extent be countered by improved product design, leading to more performance per area of GaAs.

Improved processing technologies also lead to improved process yields through the supply chain which can lead to greater efficiencies per dollar.

Alternative technologies

IQE's R&D activity coupled with excellent relationships with customers, academia and participation in industry conferences, coupled with ongoing market intelligence, keeps the management fully aware and appraised of emerging technologies.

In most cases, IQE is actively involved in the development of the next generation of materials.

Older technologies that have been displaced by IQE's materials can "chip away" at the trailing edge of the technology product curve, but the gap between capabilities of material s such as silicon, compared with IQE's advanced materials are several orders of magnitude apart whilst improvements in silicons capabilities are incremental. The company maintains a close watching brief and is also engaged in developments in silicon technology.

Board of directors

Godfrey Ainsworth (57)

Chairman, Non-Executive Director, Chairman of the Audit Committee

Godfrey Ainsworth qualified as a Chartered Accountant and was employed by Coopers & Lybrand before becoming an audit partner and then corporate finance partner with Spicer & Oppenheim. He founded Gambit Corporate Finance in 1992, a practice specialising in the provision of corporate finance services where he was Managing Partner until his retirement from the firm on 30 November 2009. He has held several Non-Executive Directorship appointments, including assignments for 3i plc and the Welsh Development Agency. He has provided advice to IQE (formerly EPI) since its inception and was appointed to the Board in 1997. He was appointed to the Board of IQE Plc in April 1999, and was appointed chairman in February 2002.

Current directorships:
Omniport Holdings Limited
Seren Photonics Limited
Mesuro Limited
Cardiff Partnership Fund

Drew Nelson OBE (58)

President and Chief Executive Officer

Drew Nelson has over 30 years experience in the semiconductor industry in a variety of research and managerial positions. Following a PhD in Semiconductor Physics, he joined BT Research Laboratories in 1981, leading the group responsible for the development of advanced optoelectronic devices for optical fibre communications. He subsequently managed the technology transfer from BT to Agilent for mass production. He co-founded EPI in 1988 (which became IQE in 1999) and was appointed Chief Executive Officer of IQE Plc in April 1999. Dr Nelson has held several Non-Executive Directorship appointments, and served on several Government and Industry bodies. He received an OBE in 2001 for services to the Electronics Industry. He is currently a member of the High Level Group appointed by the EC to oversee the implementation of Key Enabling Technologies (KETs) throughout Europe.

Current directorships:
PhotonStar LED Group plc.

Phillip Rasmussen (42)

Group Finance Director and Company Secretary

Phillip Rasmussen qualified as a Chartered Accountant with Coopers and Lybrand, a predecessor firm of PwC. During his career with PwC he spent two years in Toronto, Canada and gained significant experience of working with and advising a broad range of companies in a variety of sectors, including multinational main market and AIM listed companies. Before joining IQE, Mr Rasmussen was Director of Transaction Services with PwC in Bristol and worked with IQE on two major acquisitions during 2006. He was appointed to the Board of IQE Plc in March 2007 and appointed as Company Secretary in January 2009.

Current directorships:
none

Simon J Gibson OBE (55)

Non-Executive Director, Chairman of the Remuneration Committee

Simon is Chief Executive of Wesley Clover Corporation. Wesley Clover is an investment vehicle and holding company. He has broad management experience in high-technology industries in both North America and Europe. Before joining Wesley Clover, he was co-founder, President and CEO of Ubiquity Software Corporation. Ubiquity was acquired by Avaya Inc in 2007. Prior to Ubiquity he held senior management roles at Newbridge Networks and Mitel.
He is the Chairman and founder of the Alacrity Foundation, a graduate entrepreneurship program which operates in the UK and Canada. The Foundation provides young people with post graduate education, opportunity alignment and access to capital; with the objective of creating a new companies. He was appointed to the Board of IQE in January 2002.

Current Directorships:
Wesley Clover Wales Limited
Celtic Manor Resort Limited
Alacrity Foundation

Howard Williams (58)

Operations Director

Howard Williams has held a number of positions within both Manufacturing and Service industry sectors, with roles ranging from Engineering Management to General Management. He was a member of the founding team of EPI in 1988 and was appointed Operations Director for EPI in 1996. He was appointed General Manager of IQE Inc in 2002 and General Manager of IQE (Europe) Limited in 2003. He was subsequently appointed Chief Operations Officer in 2004 and was appointed to the Board of IQE Plc as Operations Director in December 2004.

Current directorships:
none

David Grant (65)

Senior Independent Director

David Grant has a background in engineering and technology and was appointed to the Board of IQE Plc in September 2012. He was Vice-Chancellor of Cardiff University from 2001 to 2012. Previously he held leadership positions in a number of international businesses including United Technologies Corp., Dowty Group plc and GEC plc. He has been a Vice-President of the IET, and was a Vice-President of the Royal Academy of Engineering from 2007 to 2012. He was awarded the IEE's Mensforth Gold Medal in 1996 and in 1997 he was made a CBE for his contribution to the UK's Foresight Programme. He has a PhD in Engineering Science from the University of Durham.

Current directorships:
Renishaw plc
DSTI
STEMNET

Corporate governance

Although not required to, the directors have decided to provide corporate governance disclosures similar to those that would be required of a fully listed company.

The Board recognises that it is accountable to the group's shareholders for the standard of governance and therefore seeks to maintain high standards in its management of the affairs of the group, seeing it as a fundamental part of discharging its stewardship responsibilities. Accordingly, both the Board and the audit committee continue to keep under review the group's whole system of internal control, which comprises not only financial controls but also operational controls, compliance and risk management.

Throughout the year ended 31 December 2012, the company has been in compliance with the Code provisions set out in the UK Corporate Governance Code.

The Board of Directors

The management of the group is directed by the Board of directors, which is responsible for ensuring the development and implementation of the group's overall strategy. The Board of directors comprises the non-executive Chairman Dr G H H Ainsworth, the Chief Executive Dr A W Nelson, two executive directors and two non-executive directors. There is a clear division of responsibility between the non-executive Chairman, who is responsible for the running of the Board, and the Chief Executive, who is responsible for the running of the group in accordance with the authority delegated by the Board. This ensures that there is a balance of power and authority such that no one individual has unfettered powers of decision.

The fees of the non-executive directors are paid in cash. The Board considers that the non-executive directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. The terms and conditions of appointment of the non-executive directors are available for inspection upon request to the Company Secretary.

Dr David Grant is recognised as the senior independent non-executive director to whom concerns by staff of any suspected impropriety can be conveyed in private and investigated as required by the Code of Best Practice.

Under the Company's Articles of Association each of the directors is required ordinarily to retire by rotation once every three years.

The Board held regular meetings during the year. The Board has a formal schedule of matters referred to it for decision, which includes the approval of interim and annual results, the annual budget, acquisitions and disposals, major items of capital expenditure, share capital issues, governance issues and executive appointments. The Board is provided with appropriate strategic and financial information prior to each meeting together with monthly reports to enable it to monitor the performance of the group. The Chief Executive reviews the performance of the executive directors on an annual basis.

All directors have direct access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures are followed, and are allowed to take independent professional advice if necessary at the company's expense.

Board committees

The Board has delegated specific responsibilities to the following committees:

(a) Executive Committee

The executive committee consists of the executive directors under the chairmanship of Dr A W Nelson and is responsible for the development of strategy, annual budgets and operating plans linked to the management and control of the day-to-day operations of the group. The executive committee is also responsible for monitoring key research and development programmes and for ensuring that the Board policies are carried out on a group-wide basis.

(b) Audit Committee

The audit committee consists of the non-executive directors, Dr G H H Ainsworth, S J Gibson and Dr D Grant. The committee meets at least twice a year under the chairmanship of Dr G H H Ainsworth.

The audit committee has specific written terms of reference which deal with its authority and responsibilities and these are available for inspection upon request to the Company Secretary. Its duties include monitoring

internal controls throughout the group, approving the group's accounting policies, and reviewing the group's interim results and full year financial statements before submission to the full Board. The audit committee also reviews and approves the scope and content of the group's annual risk assessment programme and the annual audit, and monitors the independence of the external auditors.

The Group has an Internal Audit function, with a scope of evaluating and testing the group's financial control procedures. The Internal Audit function reports directly to the chairman of the audit committee, and liaises with the external auditors as appropriate.

The Finance Director, other financial management and the external auditors attend meetings of the audit committee by invitation. The committee also holds separate meetings with the external auditors, as appropriate.

(c) Remuneration and Nominations Committees

The remuneration committee consists of the non-executive directors, S J Gibson, Dr G H H Ainsworth and Dr D Grant. The committee meets at least twice a year under the chairmanship of S J Gibson. The Chief Executive attends meetings of the remuneration committee by invitation to respond to questions raised by the committee, but he is excluded from any matter concerning the details of his own remuneration.

The remuneration committee has specific terms of reference which deal with its authority and duties and these are available for inspection upon request to the Company Secretary.

The remuneration committee is responsible for setting salaries, incentives and other benefit arrangements of executive directors and senior executives and overseeing the group's employee share schemes. The group's policy on directors' remuneration has been in line with the Code provisions throughout the year, full details of which are given in the remuneration report. Members of the remuneration committee do not participate in decisions concerning their own remuneration.

The Board has not established a separate nominations committee and has delegated responsibility for nominations to the remuneration committee. There are currently no plans for further appointments to the Board.

Attendance at meetings

The number of meetings held during 2012 by the Board, the audit committee and the remuneration committee are as shown below. The number of meetings attended by the executive and non-executive directors is also shown below:

	Board	Audit Committee	Remuneration Committee
Number of meetings held in 2012	7	4	2
Number of meetings attended in 2012:			
Executive			
Dr A W Nelson	6	-	2
P J Rasmussen	7	4	-
Dr H R Williams	6	-	-
Mr A G Meldrum	4	-	-
Non-executive			
Dr G H H Ainsworth	7	4	2
S J Gibson	6	4	2
Dr D Grant	3	-	-

* Dr D Grant attended all meetings following his appointment on the 18 September 2012.

In addition to the formal meetings listed above, there were a number of meetings conducted by telephone and electronic media for circumstances requiring Board, Audit Committee or Remuneration Committee approvals.

Internal control

The Board acknowledges its responsibility for the group's system of internal control, the effectiveness of which has been reviewed by the audit committee during the year and reported on to the Board. The review has taken account of any material developments up to the date of the signing of the financial statements.

The processes to identify and manage key risks to the success of the group are an integral part of the internal control environment. Such processes are on-going, are regularly reviewed and improved as necessary, and are in accordance with the internal control guidelines for directors in the UK Corporate Governance Code. They include strategic planning, the appointment of senior executives, the monitoring on a regular basis of performance, control of capital expenditure and significant revenue investment, and the setting of high standards for health, safety and environmental performance. These processes have been in place throughout the financial year and up to the date of approval of the financial statements.

The effectiveness of the control systems and procedures is monitored regularly through management self-assessment and review by internal audit. In addition, recognition is given to the external audit findings, which inform the audit committee's views of areas of increased risk.

The system of internal control comprises those controls established in order to provide assurance that the assets of the group are safeguarded against unauthorised use or disposal and to ensure the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. Any system of internal control can only provide reasonable, but not absolute, assurance against material misstatement or loss, as it is designed to manage rather than to eliminate the risk of failing to achieve the business objectives of the group.

The key procedures that the directors have established with a view to providing effective internal control are as follows:

a clearly defined organisational structure and limits of authority;

corporate policies and procedures for financial reporting and control, project appraisal, human resources, quality control, health and safety, information security and corporate governance;

the preparation of annual budgets and regular forecasts which require approval from both the group executive committee and the Board;

the monitoring of performance against budget and forecasts and the reporting of any variances in a timely manner to the Board;

regular review and self-assessment of the risks to which the group is exposed, taking steps to monitor and mitigate these wherever possible including, where appropriate, taking out insurance cover; and

approval by the audit committee of audit plans and, on behalf of the Board, receipt of reports on the group's accounting and financial reporting practices and its internal controls together with reports from the external auditors as part of their normal audit work.

an internal audit function, which is mandated to evaluate and test the Group's financial control procedures, reporting directly to the chairman of the audit committee.

Shareholder relations

The Chief Executive and the Finance Director meet on a regular basis with representatives of institutional shareholders to discuss their views and to ensure that the strategies and objectives of the group are well understood. The Chief Executive keeps the Board fully informed of the views of institutional shareholders. Issues discussed with institutional shareholders include the group's performance and the impact of any major transactions. The Chairman has met with individual shareholders on an ad hoc basis.

The company also has a manager responsible for investor relations and operates a web site, which provides details of the group's facilities and products and includes a separate investor relations section on which financial data and other significant announcements are published. The web site can be found at www.iqep.com. The group's annual report and financial statements, interim reports and other documentation is available online and by mail where requested.

The Annual General Meeting allows shareholders to raise questions with the Board, although shareholder enquiries and questions are also addressed throughout the year. In accordance with the recommendation of the Hampel Code, the company will advise shareholders attending the Annual General Meeting of the number of proxy votes lodged for each resolution in the categories 'For' and 'Against', together with the numbers 'at the Chairman's discretion' and abstentions. These will be advised after the resolutions have been dealt with on a show of hands.

Audit and related services

The Board is aware of the importance of maintaining the independence of the group auditors, and does not contract for additional services from them which would compromise their audit independence. Additional services are also subject to appropriate market testing.

The Audit Committee keeps under review the nature and extent of audit and non-audit services provided to the group by the auditors in accordance with a policy which it established in 2004. Under this policy, the award to the group's auditors of audit-related services, tax consulting services or other non-audit related services in excess of £10,000 must first be approved by the Chairman of the Audit Committee. In addition, the group's auditors will be required to make a formal report to the Audit Committee annually on the safeguards that are in place to maintain their independence and the internal safeguards in place to ensure their objectivity.

The nature of the services provided by the auditors and the amounts paid to them are as detailed below:

	Total 2012 £'000	Total 2011 £'000
PricewaterhouseCoopers LLP (group auditors)		
Fees payable to company's auditor and its associates for the audit of parent company and consolidated financial statements	18	18
Fees payable to company's auditor and its associates for other services:		
- The audit of company's subsidiaries	67	65
- Audit-related assurance services	15	5
- Due diligence	53	-
- Tax compliance service	-	-
Ernst and Young (auditors of MBE Technology Pte Limited)		
- Subsidiary company's audit	18	15
- Tax services	7	10
Total	178	113

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2012.

Activities

The principal activity of the group during the year was the development, manufacture and sale of advanced semiconductor materials. The principal activity of the company is that of a holding company for the group, the provision of services to subsidiary companies, and the research, development and provision of engineering consultancy services to the compound semiconductor industry.

Business review

A review of the group's trading during the year and its position at the year end is provided in the Chief Executive's review. The review includes key performance indicators as detailed in the Five Year Financial Summary. The principal risks and uncertainties facing the group are set out on page 39.

a) Non financial KPIs are commercially sensitive and are therefore not disclosed

b) The outlook for the Group is set out on page 24.

c) During the year and post year end the Group completed a number of transactions. Details of these transactions are disclosed in the business combination note 17 and the post balance sheet events note 25.

Dividends

The directors do not recommend the payment of a dividend (2011: £nil).

Directors

The directors in office at 31 December 2012 and throughout the year and their beneficial interests in the company's issued ordinary share capital and share options are set out in the remuneration report on page 42.

Substantial interests in shares

As at 15 March 2013, the company had been notified pursuant to the Companies Act of the following substantial interests in the shares of the company as defined by the Listing Rules in addition to those disclosed for the directors:

AXA Framlington Investment Management	9.33%
T Rowe Price Inc	8.84%
Blackrock Investment Management	6.42%
Four Capital Partners	4.94%
Nelson A W Dr	4.62%
Herald Investment Management Limited	4.40%
Barclays Stock Brokers Limited	3.84%
M&G Investment Management	3.27%

Shareholder analysis by Argus Vickers

Research and development

The group incurred costs in respect of research and development during the year of £4,185,000 (2011: £3,773,000) of which £4,042,000 (2011: £3,666,000) has been capitalised in accordance with IAS 38 ("Intangible assets"). The remaining research and development costs totalling £143,000 (2011: £107,000) have been charged to the income statement.

Payment terms

The group seeks to agree favourable credit terms with its suppliers where possible, and adhere to the agreed terms. The group's average number of days' purchases outstanding in respect of trade creditors at 31 December 2012 was 85 days (2011: 82 days).

Employment policies

It is the group's policy that there should be no discrimination in considering applications for employment including those from disabled persons. All employees, including the disabled, are given equal opportunities in terms of career development and promotion. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

The group remains committed to its policy of keeping employees fully informed about all matters which concern them. Formal communications are used to achieve this objective, including intranet, e-mail and notice board announcements. Employee involvement takes different forms in each subsidiary, ranging from formal committee meetings to less formal discussion groups. Schemes have been implemented to ensure that employees are properly rewarded for performance and loyalty.

Going concern

The directors, after making enquiries, have considered the future prospects of the group and have a reasonable expectation that it will have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these financial statements.

Principal risks and uncertainties

The Board considers that the principal risks and uncertainties facing the group are:

Competition

IQE's business model involves building close working relationships with its customers and often involves forming multilevel partnerships from the product design stages through to pilot and volume production. Such arrangements can lead to long qualification timescales but once a product range and relationship is established, it can also create significant barriers to entry for competitors.

In some cases, customers seek second source supply arrangements to meet their own business continuity planning policies. As such, there is a risk that market share may be eroded. The Board believes that IQE's strategy to provide multiple site capabilities for all leading product lines provides an effective mitigation against this risk.

Technological change

Any technology based company faces a threat from technology change that has not been anticipated. IQE actively engages with customers, educational institutions and government agencies on a range of research and development (R&D) programmes. The company's involvement in R&D activities coupled with its broad range of products and process technologies helps ensure a forward looking approach that positions IQE as a driver of technological change.

Supply chain

Changes in the supply chain such as scarcity of key raw materials could impact the business. IQE builds close relationships with its key suppliers in order to keep well informed about potential supply issues. The raw materials which sustain IQE's products are not scarce resources.

Retention of key employees

The Board recognises that the retention and development of its workforce is critical to its long term success as a leading technology group. IQE's people are the heart of the business and in order to promote the development and retention of its staff IQE offers career progression, personal development and a range of benefits and incentives to its staff. This is reflected in low staff turnover, with many employees who have been with the company since it was formed over twenty years ago.

In addition, IQE operates a highly effective, robust, and fully documented quality management system across all of its operations. These systems ensure that all key data and procedures are fully documented, reflecting IQE's "learning organisation" philosophy. These rigorous systems provide IQE and its customers with a high level of confidence in terms of process reproducibility and product traceability, and minimise the potential impact of losing key personnel.

Treasury

IQE operates a central treasury which acts in accordance with specific board policies. Speculative transactions are not permitted.

Interest rate risk

The Board is aware of the risks associated with changes in interest rates and does not speculate on future changes in interest rates or currencies.

The group's policy is to regularly review its exposure to interest rate risk, and in particular the mix between fixed and floating rate facilities. The percentage of borrowings on fixed rate terms at 31 December 2012 was 29% (2011: 1%). Floating rate liabilities are primarily indexed to LIBOR.

The group did not enter into any interest rate swap instruments during 2012. This remains under regular review.

As a guide to the sensitivity of the group's results to movements in interest rates, a 100 basis point (1%) movement in interest rates would have impacted the 2012 annual interest charge by approximately £100,000.

Credit risk

The majority of the group's revenues are derived from large multinational organisations. Therefore the credit risk is considered to be small.

Where the group assesses a potential credit risk, this is dealt with either by up-front payment prior to the shipment of goods or by other credit risk mitigation measures. As a result the group has historically had and continues to have a very low level of payment default.

Currency risk

(a) Cash flow risk

The group's presentational currency is sterling. However, the majority of sales are denominated in US dollars. Therefore, the group's cash flows are affected by fluctuations in the rate of exchange between Sterling and the US dollar.

This exposure is managed by a natural currency hedge because a significant portion of the group's cost base is also denominated in US dollars. In particular, the majority of the group's raw materials are purchased in US dollars, and a significant portion of labour and overheads are also denominated in US dollars as three of the group's principal subsidiaries are situated in North America.

To a lesser extent, the group also generates sales in other currencies including Yen and Euros which are also partially hedged where possible by purchases of some raw materials in these currencies.

Taking into account the extent of the natural hedge within the business model, management periodically use forward exchange contracts to mitigate the impact of the residual foreign currency exposure. As at 31 December 2012 there were no contracts in place.

(b) Fair value risk

The group has operations in the UK, North America and Asia. Translation exposures that arise on converting the results of overseas subsidiaries are not hedged. Net assets held in foreign currencies are hedged wherever practical by matching borrowings in the same currency.

As a guide to the sensitivity of the group's results to movements in foreign currency exchange rates, a one cent movement in the US dollar to Sterling rate would impact annual earnings by approximately £100,000 (2011: £100,000).

Liquidity risk

Prudent liquidity risk management requires maintaining sufficient cash and cash equivalents and the availability of funding through committed credit facilities.

Management utilises detailed rolling cash flow forecasts as part of its cash management. This includes weekly forecasts for the next quarter and monthly forecasts for the next 12 months.

Capital risk

The group's main objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The group defines total capital as equity in the consolidated balance sheet plus net debt or less net funds (note 23). Total capital at 31 December 2012 was £106,079,000 (2011: £76,671,000).

Consistent with others in the industry, the group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. At 31 December 2012 the gearing ratio was 15% (2011: 5%).

All covenants in relation to the group's borrowing facilities have been complied with during the year.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and the company and of the profit or loss of the group for that period.

In preparing these financial statements, the directors are required to:

select suitable accounting policies and then apply them consistently;

make judgements and accounting estimates that are reasonable and prudent;

state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;

prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the group's website, www.iqep.com.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

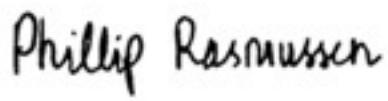
Provision of information to auditors

So far as the directors are aware, there is no relevant audit information of which the company's auditors are unaware. The directors have taken all the steps that ought to have been taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Independent Auditors

A resolution to reappoint PricewaterhouseCoopers LLP will be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors and signed on behalf of the Board.



Phillip Rasmussen

Finance Director & Company Secretary

20 March 2013

Remuneration report

Introduction

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2007 which introduced new statutory requirements for the disclosure of directors' remuneration. Although not required to, the directors have decided to provide directors' remuneration disclosures similar to those that would be required of a fully listed company. In particular, the Remuneration Report describes how the Board has applied the principles of good governance relating to directors' remuneration set out in the UK Corporate Governance Code. A resolution to approve the report will be proposed at the forthcoming Annual General Meeting of the company.

The report has been divided into separate sections for unaudited and audited information.

Unaudited information

(a) Remuneration Committee

The Board considers itself ultimately responsible for the framework and cost of executive remuneration, but has delegated responsibility for determining the remuneration levels and conditions of service for executive directors and senior executives to the remuneration committee. The committee's approach is fully consistent with the company's overall philosophy that all employees should be competitively rewarded in order to attract and retain their valued skills in the business, as well as supporting corporate strategy by directly aligning executive management with the company's strategic business goals.

The remuneration committee is comprised exclusively of independent non-executive directors of the company who have no personal financial interest, other than as shareholders, in the matters to be decided. The members of the committee throughout the year were Dr G H H Ainsworth and S J Gibson. The Chairman of the committee is S J Gibson.

The committee follows the provisions of Schedule A to the UK Corporate Governance Code, and is responsible for determining the company's policy on compensation of executive directors and the basis of their service agreements with due regard to the interests of shareholders. It also approves the allocation of share options to employees.

The committee operates under clear written terms of reference and has access to and takes independent professional advice as appropriate. The committee met four times during 2012 to review the performance of the executive directors and other senior executives, and set the scale and structure of their remuneration.

(b) Remuneration policy

In establishing its remuneration policy, the committee has given full consideration to Schedule B of the Best Practices Provisions annexed to the Listing Rules of the Financial Services Authority. The remuneration packages for executive directors and senior executives, as determined by the committee, are intended to attract and retain high quality executives, induce loyalty and motivate them to achieve a high level of corporate performance in line with the best interests of shareholders, while not being excessive. The remuneration of the executive directors consists of annual salary, performance bonus, share options, taxable benefits in kind and pension contributions.

There is an annual review at which the committee approves the basic salary and profit sharing bonus scheme for each executive director. The committee receives input from the Chief Executive regarding recommended packages for executive directors and senior executives.

(c) Basic salary

Basic salary is determined by reference to individual responsibilities, performance and external market data.

(d) Performance bonus

Bonus payments are linked to the executive directors achieving internal annual plan targets in respect of profitability and other non-financial performance criteria. Bonuses were awarded to certain directors in respect of 2012 in accordance with this scheme.

(e) Taxable benefits in kind

The company reimbursed all fuel and maintenance costs in respect of the executive directors' private cars, and these costs are treated as taxable benefits in kind. Other taxable benefits comprise medical health and life insurance.

(f) Share incentive schemes

The company operates a number of share incentive schemes. The IQE Plc Share Option Scheme, as adopted on 26 May 2000 and amended by shareholders at the company's Annual General Meeting on 17 May 2002, allows the company to grant options over up to 15% of the issued share capital and those options are subject to performance conditions.

During the year, the committee approved the grant of 2,761,361 share options to staff (2011: 5,889,277 share options). During 2012, Directors were awarded nil cost options over 6,710,583 ordinary shares in the company (2011: nil).

As at 31 December 2012, 38,693,514 share options (2011: 51,043,125 share options) granted under the IQE Plc Share Option Scheme remain outstanding with exercise prices ranging from nil cost to 86p/option (2011: nil cost to 86p/option). 14,935,129 share options were exercised by directors during the year (2011: 6,241,500). 2,251,349 of directors share options lapsed during the year (2011: nil) The numbers and prices of share options at 31 December 2012 and 31 December 2011 were as follows:

Option price	2012 No. of options	2011 No. of options
Share options of nil cost to 10p/option	21,133,728	23,446,947
Share options in excess of 10p/option to 20p/option	14,234,831	25,377,375
Share options in excess of 20p/option to 30p/option	1,970,000	754,000
Share options in excess of 30p/option	1,354,956	1,464,803
Total	38,693,514	51,043,125

(g) Directors' interests in ordinary shares of IQE Plc

The interests in ordinary shares of IQE Plc of those directors holding office at 31 December 2012 were as follows:

Name of director	As at 1 January 2012	As at 31 December 2012
Executive:		
Dr A W Nelson	27,482,913	29,830,132
Dr H R Williams	678,342	1,672,430
P J Rasmussen	495,000	852,822
Non-Executive:		
Dr G H H Ainsworth	3,121,999	3,121,999
S J Gibson	301,855	301,855
Dr D Grant	-	-
Total	32,080,109	35,779,238

The interests in share options in IQE Plc of those directors who held office at 31 December 2012 were as follows:

Name of director	As at 1 January 2012	Options granted	Options exercised	As at 31 December 2012	Date(s) from which exercisable
Executive:					
Dr A W Nelson	12,845,124	2,370,669	(10,283,219)	4,932,574	1 Jan 2012 to 1 Jan 2015
Dr H R Williams	5,386,433	1,499,656	(3,494,088)	3,392,001	1 Jan 2012 to 1 Jan 2015
P J Rasmussen	2,586,393	1,499,656	(1,157,822)	2,928,227	1 Jan 2012 to 1 Jan 2015
Non-Executive:					
Dr G H H Ainsworth	-			-	
S J Gibson	-			-	
Dr D Grant	-			-	
Total	20,817,950			11,252,802	

The highest and lowest mid-market share prices in respect of the shares of IQE Plc during 2012 were 33.25p/share and 18.72p/share respectively (2011: 59.00p/share and 17.75p/share respectively). The mid-market price of IQE plc shares closed at 30.75p/share as at 31 December 2012 (2011: 18.72p/share).

(h) Pension arrangements

The executive directors are members of the group defined contribution pension schemes and their pension contributions are based on a percentage of basic annual salary. Their dependants are eligible for the payment of a lump sum in the event of death in service. There have been no changes in the terms of directors' pension entitlements during 2012, and there were no unfunded pension promises or similar arrangements for directors at 31 December 2012.

(i) Executive Directors' service contracts

It is the company's policy to appoint executive directors under service agreements which are terminable by either party giving between six and twelve months' notice. Each of the agreements contain post-termination restrictive covenants, which place limitations on solicitation of customers and employees of the group and on acting in competition with the business of the group. There are no predetermined provisions for compensation on termination within executive directors' service agreements. However, the company is against rewards for failure and believes that severance arrangements should be restricted to basic pay and consequential payments such as earned bonus. In circumstances where there is no conflict of interest, the company allows executive directors to serve as non-executive directors elsewhere. In such circumstances the remuneration received is retained by the director.

(j) Non-Executive Directors' contracts

The non-executive directors have entered into service agreements with the company, and these are terminable by either party on three months' notice. Non-executive directors have specific terms of engagement, and their fees are determined by the Board within the limits set by the company's Articles of Association. Non-executive directors do not take part in discussions on their own remuneration. There were no changes to non-executive remuneration during 2012.

The services of Dr G H H Ainsworth were paid in cash. £70,000 (2011: £70,000), was paid to Horton Corporate Finance for his fees and expenses for 2012. Dr G H H Ainsworth is a director of Horton Corporate Finance. VAT was charged on the invoices from Horton Corporate Finance and this was recovered by the company.

The services of S J Gibson were paid in cash. £35,000 (2011: £35,000), was paid to Fishstone Limited for his fees and expenses for 2012. S J Gibson is a shareholder in Fishstone Limited. VAT was charged on the invoices from Fishstone Limited and this was recovered by the company.

The services of Dr D Grant were payable in cash. £12,000 (2011: £nil).

The non-executive directors receive no other pay or benefits, do not participate in the company's share schemes, and are not eligible for pension scheme membership. Neither had any share options in the company at 31 December 2012 and it is not intended that share options will be issued to them in the future in accordance with Best Practice Guidelines issued by the Association of British Insurers.

(k) Share price performance

The IQE plc share price has been compared with the AIM market all-share index for the five year period 2007 to 2012 as this was considered to be the most representative market group.

Five year share price performance: IQE plc share price compared with AiM all share index, 2008 to 2012.

Audited information

(a) Aggregate directors' remuneration

The total amounts paid for directors' remuneration during 2012 were as follows:

	2012 £'000	2011 £'000
Basic salaries	718	752
Bonuses	51	134
Non-executive fees	117	105
Subtotal salaries and fees	835	991
Car allowance	115	116
Benefits in kind	20	28
Money purchase pension contributions	49	45
Total	1,070	1,180

(b) Directors emoluments

The aggregate emoluments paid to each director during 2012 were as follows:

Name of director	Salary fees and bonuses £'000	Car allowance £'000	Benefits in kind £'000	Pensions £'000	2012 Total £'000	2011 Total £'000
Executive:						
Dr A W Nelson	271	42	9	-	**322**	367
Dr H R Williams	171	27	2	20	**220**	243
P J Rasmussen	167	27	8	24	**226**	249
A G Meldrum (Resigned 21 September 2012)	160	19	1	6	**186**	216
Non-Executive:						
Dr G H H Ainsworth					**70**	70
S J Gibson					**35**	35
Dr D Grant (Appointed 18 September 2012)					**12**	-
Total					**1,070**	1,180

Notes:

In aggregate, the executive directors made a gain of £3,493,661 (2011: £2,465,000) on the exercise of share options during the year. The majority of the shares obtained on the exercise of these options were sold in order to satisfy the option price and tax arising on the exercise. The shares retained are included in the closing totals shown on the next page. Dr Nelson made a gain of £1,570,762 as part of these exercises.

Approval

This report was approved by the Board of Directors on 20 March 2013 and signed on its behalf by:

S J Gibson, OBE

Independent auditors' report to the members of IQE plc

We have audited the group and parent company financial statements (the "financial statements") of IQE plc for the year ended 31 December 2012 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements, the Consolidated and Parent Company Statements of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 41, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2012 and of the group's profit and group's and parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

The directors have requested, (because the company applies Listing Rules 9.8.6R 5 and 6 of the Financial Services Authority as if it were a listed company), that we review the parts of the Corporate Governance Report relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review by the Listing Rules of the Financial Services Authority. We have nothing to report in respect of this review.

At the request of the directors, we have also audited the part of the Directors' Remuneration Report that is described as having been audited. In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Mark Ellis (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cardiff
20 March 2013

Financial statements

Consolidated income statement for the year ended 31 December 2012

	Note	2012 £'000	2011 £'000
Revenue	3	**87,961**	**75,318**
Cost of sales		(69,491)	(57,142)
Gross profit		**18,470**	**18,176**
Selling, general and administrative expenses		(11,456)	(10,803)
Operating profit before exceptional items		**7,584**	**7,373**
Exceptional items	4	(570)	-
Operating profit	4	**7,014**	**7,373**
Finance costs	6	(886)	(481)
Profit before tax		**6,128**	**6,892**
Income tax credit	7	503	1,551
Profit for the year attributable to equity shareholders		**6,631**	**8,443**
Adjusted earnings per share	9	1.59p	1.86p
Basic earnings per share	9	1.16p	1.62p
Adjusted diluted earnings per share	9	1.51p	1.74p
Diluted earnings per share	9	1.10p	1.51p

The notes on pages 56 to 80 form part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2012

	2012 £'000	2011 £'000
Profit for the year	6,631	8,443
Currency translation differences on foreign currency net investments	(2,497)	432
Foreign exchange hedges	-	(598)
Total comprehensive income for the year	**4,134**	**8,277**

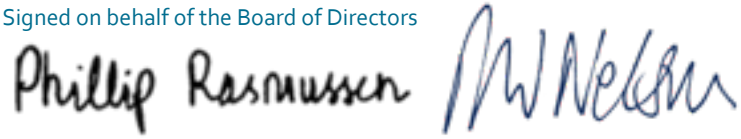
Consolidated balance sheet as at 31 December 2012

	Note	2012 £'000	2011 £'000
Non-current assets:			
Intangible assets	10	54,165	32,706
Property, plant and equipment	11	62,320	37,348
Investments	12	3,205	-
Deferred tax asset	7	14,549	1,876
Total non-current assets		**134,239**	**71,930**
Current assets:			
Inventories	13	18,351	15,122
Trade and other receivables	14	19,186	14,338
Cash and cash equivalents		2,773	3,233
Total current assets		**40,310**	**32,693**
Total assets		**174,549**	**104,623**
Current liabilities:			
Borrowings	16	(2,428)	(49)
Trade and other payables	15	(31,709)	(23,157)
Total current liabilities		**(34,137)**	**(23,206)**
Non-current liabilities:			
Borrowings	16	(15,828)	(7,105)
Other payables	15	(34,386)	(1,562)
Total non-current liabilities		**(50,214)**	**(8,667)**
Total liabilities		**(84,351)**	**(31,873)**
Net assets		**90,198**	**72,750**
Shareholders' equity:			
Share capital	18	5,882	5,251
Share premium		33,445	22,122
Retained earnings		42,749	36,118
Other reserves		8,122	9,259
Total equity		**90,198**	**72,750**

The notes on pages 56 to 80 form part of these financial statements.

These financial statements were approved by the Board of Directors on 20 March 2013

Signed on behalf of the Board of Directors



P J Rasmussen Dr A W Nelson

Consolidated statement of changes in equity for the year ended 31 December 2012

	Share capital £'000	Share premium £'000	Retained earnings £'000	Exchange rate reserve £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2012	**5,251**	**22,122**	**36,118**	**5,272**	**3,987**	**72,750**
Comprehensive income						
Profit for the year	-	-	6,631	-	-	6,631
Foreign exchange translation differences	-	-	-	(2,497)	-	(2,497)
Total comprehensive income	**-**	**-**	**6,631**	**(2,497)**	**-**	**4,134**
Transactions with owners						
Employee share option scheme	-	-	-	-	1,360	1,360
Issues of ordinary shares	631	11,323	-	-		11,954
Total transactions with owners	**631**	**11,323**	**-**	**-**	**1,360**	**13,314**
Balance at 31 December 2012	**5,882**	**33,445**	**42,749**	**2,775**	**5,347**	**90,198**
Balance at 1 January 2011	**5,153**	**21,237**	**28,019**	**4,840**	**3,025**	**62,274**
Comprehensive income						
Profit for the year	-	-	8,443	-	-	8,443
Foreign exchange translation differences	-	-	-	432	-	432
Foreign exchange hedges	-	-	-	-	(598)	(598)
Total comprehensive income	**-**	**-**	**8,443**	**432**	**(598)**	**8,277**
Transactions with owners						
Employee share option scheme	-	-	(344)	-	1,284	940
Other issues of ordinary shares	98	885	-	-	276	1,259
Total transactions with owners	**98**	**885**	**(344)**	**-**	**1,560**	**2,199**
Balance at 31 December 2011	**5,251**	**22,122**	**36,118**	**5,272**	**3,987**	**72,750**

The notes on pages 56 to 80 form part of these financial statements.

Consolidated cash flow statement for the year ended 31 December 2012

	Note	2012 £'000	2011 £'000
Cash flows from operating activities:			
Cash inflow from operations	21	**4,109**	**10,823**
Net interest paid		(616)	(515)
Income tax received		1,284	13
Net cash generated from operating activities		**4,777**	**10,321**
Cash flows from investing activities:			
Acquisition deferred consideration		(7,043)	(1,134)
Investment in Solar Junction Corporation	12	(3,205)	-
Development expenditure		(4,042)	(3,666)
Investment in other intangible fixed assets		(307)	(328)
Purchase of property, plant and equipment		(11,562)	(15,517)
Proceeds from sale of property, plant and equipment		-	90
Net cash used in investing activities		**(26,159)**	**(20,555)**
Cash flows from financing activities:			
Issues of ordinary share capital		11,445	616
Loans and leases repaid	22	(1,383)	(6,933)
Loans and leases received	22	10,877	7,267
Net cash generated from financing activities		**20,939**	**950**
Net decrease in cash and cash equivalents		**(443)**	**(9,284)**
Cash and cash equivalents at 1 January	23	3,233	12,507
Exchange gains on cash and cash equivalents		(17)	10
Cash and cash equivalents at 31 December	**23**	**2,773**	**3,233**

The notes on pages 56 to 80 form part of these financial statements.

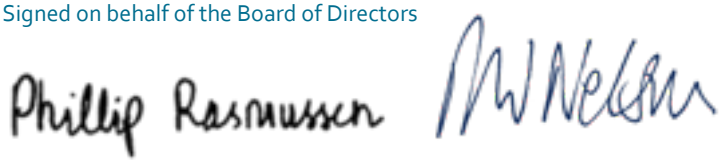
Parent company balance sheet for the year ended 31 December 2012

	Note	2012 £'000	2011 £'000
Non-current assets:			
Investments	12	16,143	13,687
Total non-current assets		**16,143**	**13,687**
Current assets:			
Trade and other receivables	14	56,392	46,134
Cash and cash equivalents		3,161	240
Total current assets		**59,553**	**46,374**
Total assets		**75,696**	**60,061**
Current liabilities:			
Trade and other payables	15	(684)	(1,737)
Total current liabilities		**(684)**	**(1,737)**
Non-current liabilities:			
Trade and other payables	15	(484)	(1,562)
Borrowings	16	(9,565)	(7,087)
Total non-current liabilities		**(10,049)**	**(8,649)**
Total liabilities		**(10,733)**	**(10,386)**
Net assets		**64,963**	**49,675**
Shareholders' equity:			
Share capital	18	5,882	5,251
Share premium		33,445	22,122
Retained earnings		20,103	18,129
Other reserves		5,533	4,173
Total equity		**64,963**	**49,675**

The notes on pages 56 to 80 form part of these financial statements.

These financial statements were approved by the Board of Directors on 20 March 2013

Signed on behalf of the Board of Directors



P J Rasmussen Dr A W Nelson

Parent company statement of changes in equity for the year ended 31 December 2012

	Share capital £'000	Share premium £'000	Retained earnings £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2011	**5,153**	**21,237**	**16,886**	**3,423**	**46,699**
Comprehensive income					
Profit for the year	-	-	1,243	-	1,243
Total comprehensive expense	**-**	**-**	**1,243**	**-**	**1,243**
Transactions with owners					
Employee share option scheme	-	-	-	476	476
Other issues of ordinary shares	98	885	-	274	1,257
Total transactions with owners	**98**	**885**	**-**	**750**	**1,733**
Balance at 31 December 2011	**5,251**	**22,122**	**18,129**	**4,173**	**49,675**
Comprehensive income					
Profit for the year	-	-	1,974	-	1,974
Total comprehensive income	**-**	**-**	**1,974**	**-**	**1,974**
Transactions with owners					
Employee share option scheme	-	-	-	1,360	1,360
Share placing	438	9,546	-	-	9,984
Other issues of ordinary shares	193	1,777	-	-	1,970
Total transactions with owners	**631**	**11,323**	**-**	**1,360**	**13,314**
Balance at 31 December 2012	**5,882**	**33,445**	**20,103**	**5,533**	**64,963**

The notes on pages 56 to 80 form part of these financial statements.

Parent company cash flow statement for the year ended 31 December 2012

	Note	2012 £'000	2011 £'000
Cash flows from operating activities:			
Cash outflow from operations	21	(10,717)	(8,453)
Interest received		2,845	2,167
Taxation		75	-
Net cash used in operating activities		**(7,797)**	**(6,286)**
Cash flows from investing activities:			
Investment in Solar Junction		(3,205)	-
Net cash used in investing activities		**(3,205)**	**-**
Cash flows from financing activities:			
Issues of ordinary share capital		11,445	616
Loans and leases (repaid)		-	-
Loans and leases received		2,478	3,408
Net cash generated from financing activities		**13,923**	**4,024**
Net increase/(decrease) in cash and cash equivalents		**2,921**	**(2,262)**
Cash and cash equivalents at 1 January		240	2,502
Cash and cash equivalents at 31 December		**3,161**	**240**

The notes on pages 56 to 80 form part of these financial statements.

Notes to the financial statements

1. Significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented.

General Information

The company is a public limited company, which is listed on the Alternative Investment Market (AIM) and incorporated and domiciled in Great Britain. The address of its registered office is Pascal Close, St Mellons, Cardiff, CF_3 0LW.

Basis of preparation

This financial information has been prepared on a going concern basis under the historical cost convention and in accordance with the Companies Act 2006 applicable to companies reporting under IFRS, International Financial Reporting Standards ("IFRS") as adopted by the European Union and IFRIC interpretations expected to be in issue at 31 December 2012. The application of these standards and interpretations necessitates the use of estimates and judgements. The main areas involving estimates are set out below in note 2.

Changes in accounting policy and disclosures

a) New and amended standards adopted by the group

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 1 January 2012 that would be expected to have a material impact on the group.

b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2012 and not early adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the group.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and its subsidiary undertakings. Subsidiaries are all entities over which the Group has the power to govern their financial and operating policies generally accompanying a shareholding of more than half of the voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from intercompany transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group. As permitted by Section 408 of the Companies Act 2006, the income statement of the parent company has not been presented.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of an acquisition is measured at the fair value of the consideration. The acquired identifiable assets, liabilities and contingent liabilities are recognised at their fair value at the date of acquisition.

Where the fair values of contingent deferred consideration, assets and liabilities acquired are initially recognised on a provisional basis, these are reassessed during the 12 month period following the date of the business combination. Adjustments to the fair values as at the date of acquisition within this 'measurement period' are recorded, with any net impact being added to or deducted from the goodwill recognised. Such adjustments are recognised in both the current period and restated comparative period balance sheets as if the final fair values had been used in the initial recognition of the acquisition.

The group recognises any non-controlling interest on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

Acquisition related costs are expensed as incurred.

Intangible assets

a) Goodwill

Goodwill arising on an acquisition is recognised as an asset and initially measured at cost, being the excess of the fair value of the consideration over the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is not amortised. However, it is reviewed for potential impairment at least annually or more frequently if events or circumstances indicate a potential impairment. For the purpose of impairment testing, goodwill is allocated to each of the Cash Generating Units to which is relates. Any impairment identified is charged directly to Consolidated Income Statement. Subsequent reversals of impairment losses for goodwill are not recognised.

b) Patents trademarks and licences

Separately acquired patents, trademarks and licences are shown at historical cost. Patents, trademarks and licences acquired in a business combination are recognised at fair value at the acquisition date. Patents, Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives of 10 to 15 years.

The carrying value of patents, trademarks and licences is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

c) Development costs

Expenditure incurred that is directly attributable to the development of new or substantially improved products or processes is recognised as an intangible asset when the following criteria are met :

- the product or process is intended for use or sale;
- the development is technically feasible to complete;
- there is an ability to use or sell the product or process;
- it can be demonstrated how the product or process will generate probable future economic benefits;
- there are adequate technical, financial and other resources to complete the development; and
- the development expenditure can be reliably measured.

Directly attributable costs refers to the materials consumed; the directly attributable labour; and the incremental overheads incurred in the development activity. General operating costs, administration costs and selling costs do not form part of directly attributable costs.

All research and other development costs are expensed as incurred.

Capitalised development costs are amortised on a straight line basis over the period during which the economic benefits are expected to be received, which typically range between 2 and 5 years. The estimated remaining useful lives of development costs are reviewed at least on an annual basis.

The carrying value of capitalised development costs is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

d) Software

Directly attributable costs incurred in the development of bespoke software for the group's own use are capitalised and amortised on a straight line basis over the expected useful life of the software, which typically range between 3 and 5 years.

The carrying value of capitalised software costs is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

The costs of maintaining internally developed software, and annual license fees to utilise third party software, are expensed as incurred.

e) Other intangibles recognised on acquisition

Other intangible assets which form part of the identifiable net assets of an acquired business are recognised at their fair value and amortised on a systematic basis over their useful economic life, which is up to seven years.

This includes customer contracts, the fair value of which have been estimated based an imputed royalty stream to recover the estimated cost of product development and qualification to which the contract relates.

The carrying value of other intangible assets is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any provision for impairment. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use. Depreciation is calculated to write down the cost of fixed assets to their residual values on a straight-line basis over the following estimated useful economic lives:

Freehold buildings	25 years
Leasehold improvements	5 to 27 years
Plant and machinery	5 to 15 years
Fixtures and fittings	4 to 5 years

No depreciation is provided on land or assets yet to be brought into use.

The assets residual values and useful economic lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

The carrying value of property, plant and equipment is reviewed for potential impairment at least annually. Any impairment identified is immediately charged to the Consolidated Income Statement.

Impairment of non-current assets

Non-current assets are reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value (less disposal costs) and value in use.

Value in use is based on the present value of the future cash flows relating to the asset, discounted at the Group's weighted average cost of capital. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (Cash Generating Units).

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. Cost comprises direct materials and, where applicable, direct labour costs and attributable overheads that have been incurred in bringing the inventories to their present location and condition based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. In the consolidated balance sheet, bank overdrafts are shown within borrowings in current liabilities.

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Financial instruments

Financial assets and liabilities are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the financial instrument.

The financial assets held by the group are other equity investments, receivables and cash and cash equivalents. Receivables do not carry interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. Cash and cash equivalent comprise cash in hand. Other equity investments are held at cost less provision for impairment.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Trade payables are stated at their nominal value and do not bear interest.

Equity instruments issued by the company are recorded at the proceeds received net of any direct issue costs.

Interest bearing loans are recorded at the proceeds received net of any direct issue costs. Finance charges are accounted for on an accrual basis using the effective interest method.

The group does not use derivative financial instruments for speculative purposes. The group uses forward currency contracts as appropriate to manage foreign exchange risk.

Detailed disclosures of the group's financial instruments are provided in notes 15 and 16.

Leases

Leases which transfer substantially all the risks and rewards of ownership of an asset are treated as a finance lease. Assets held under finance leases are capitalised at their fair value at the inception of the lease and depreciated over the estimated useful economic life of the asset or lease term if shorter. The finance charges are allocated to the Consolidated Income Statement in proportion to the capital amount outstanding.

All other leases are classified as operating leases. Operating lease rentals are charged to the Consolidated Income Statement in equal annual amounts over the lease term.

Revenue recognition

Revenue represents the amounts receivable for goods and services provided in the ordinary course of business net of value added tax and other sales related taxes. Revenue is recognised when the risks and rewards of the underlying sale have been transferred to the customer, which is on the delivery of the goods or services and acceptance by the customer.

Accrued income is recognised for sales where, at the balance sheet date, billing has not yet taken place but contractual terms dictate that the risks and rewards have been transferred to the customer and the customer is committed to payment. Billing is deferred to a contractually defined trigger point.

An acquisition was made during the year, where the consideration is being settled through agreed contractual price discounts. The revenues of products which are subject to this discount, are recognised at full market value. On settlement of the transaction, the discount is applied to reduce the deferred consideration balance.

Segmental reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Board of Directors, who oversee the allocation of resources and the assessment of operating segment performance.

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of components operating in other economic environments.

Pension costs

The group operates defined contribution pension schemes. Contributions are charged in the Consolidated Income Statement as they become payable in accordance with the rules of the scheme.

Share based payments

The group operates a Share Option Scheme, under which the group receives services from employees as consideration for share options in IQE plc. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense in the Consolidated Income Statement. The total amount to be expensed is determined by reference to the fair value of the options granted including any market performance conditions (for example, an entity's share price); excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period) and including the impact of any non-vesting conditions (for example, the requirement for employees to save).

Non-market performance and service conditions are included in assumptions about the number of options that are expected to vest. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the group revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

When the options are exercised, the company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium. The scheme is equity settled.

In the company's own accounts, the grant of share options to the employees of subsidiary undertakings is treated as a capital contribution. Specifically, the fair value of employee services received (measured at the date of grant) is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity in the parent entity accounts.

The social security contributions payable in connection with the grant of the share options is considered an integral part of the grant itself, and the change will be treated as a cash-settled transaction.

Foreign currencies

Items included in the financial statements of each subsidiary are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The consolidated financial statements are presented in sterling, which is the group's presentational currency.

Foreign currency transactions are translated into the subsidiaries functional currency at the rates of exchange ruling at the date of the transaction, or at the forward currency hedged rate where appropriate. Monetary assets and liabilities in foreign currencies are translated into the subsidiaries functional currency at the rates ruling at the balance sheet date. All exchange differences are taken to the income statement.

The balance sheets of overseas subsidiaries are translated into sterling at the closing rates of exchange at the balance sheet date, whilst the income statements are translated into sterling at the average rate for the period. The resulting translation differences are taken directly to reserves.

Foreign exchange gains and losses on the retranslation of foreign currency borrowings that are used to finance overseas operations are accounted for on the 'net investment' basis and are recorded directly in reserves provided that the hedge is 'effective' as defined in IAS 39 "Financial Instruments : recognition and measurement".

Taxation

Income tax on the profit or loss for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year using rates substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of prior years.

Amounts receivable from tax authorities in relation to R&D tax relief claims are recognised as a credit within the group's tax charge. Where amounts are outstanding at the year end and have not been formally agreed, an appropriate estimate of the amount is included within other receivables.

Deferred tax is provided in full on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts used for taxation purposes. Deferred tax is calculated at the tax rates that have been enacted or substantially enacted at the balance sheet date. Deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax liabilities are recognised for taxable temporary differences, unless specifically exempt.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

Tax is recognised in the Consolidated Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Investment in subsidiaries

Investments in subsidiaries are held at cost of investment less provision for impairment in the parent company accounts.

Other equity investments

Other equity investments are held at cost less provision for impairment in both the parent company and group accounts on the basis that the Group (and Company) does not have the ability to exert significant influence or control over the strategic and operating activities of the other equity investments.

2. Critical accounting judgements and key sources of estimation uncertainty

The group's principal accounting policies are described in note 1. The application of these policies necessitates the use of estimates and judgements in a number of areas. Accordingly, the actual amounts may differ from these estimates. The main areas involving estimation are set out below:

(a) Impairment of intangible assets

Goodwill on the group's balance sheet is not subject to amortisation because it is assumed to have an indefinite useful life. In accordance with IAS 36 "Impairment of assets", the carrying value of goodwill is assessed at least annually for impairment. This assessment is based on cash flow forecasts. In light of these forecasts the Board has concluded that goodwill is not impaired.

The group capitalises the cost of developing new and substantially improved products and processes if there is a reasonable expectation of obtaining an appropriate economic return. This necessitates an assessment of the future technical viability and future commercial benefits of the product or process. The carrying value for each project is assessed for impairment on an on-going basis.

(b) Impairment of receivables

Trade and other receivables are carried at the contractual amount due less any estimated provision for non-recovery. Provision is made based a number of factors including the age of the receivable, previous collection experience and the financial circumstances of the counterparty.

(d) Inventory provisions

Inventories are carried at the lower of cost and net realisable value. Provision is made based on a number of factors including the age of inventories, the risk of obsolescence and the expected future usage.

(e) Acquisition fair values

An assessment is made of the fair value of the purchase consideration and net assets acquired was undertaken for the acquisition made during 2012. The basis of the key judgments made is set out in note 17.

(d) Deferred tax assets

Deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. This necessitates an assessment of future trading forecasts for each relevant tax authority, capital expenditures and the utilisation of tax losses.

3. Segmental analysis

The board of directors considers that the wireless, photonics and electronics markets are the group's primary reporting segments. The board of directors assesses the performance of these operating segments based on their earnings before interest, tax, depreciation, amortisation and share based payments (EBITDA).

Further detail on the nature of the segments is provided in the Chief Executive's Review.

2012	Wireless £'000	Photonics £'000	Electronics £'000	Total £'000
Income statement				
Revenue	68,962	18,049	950	87,961
EBITDA	**12,929**	**3,732**	**(224)**	**16,437**
Exceptional items	(455)	(115)	-	(570)
Share based payments	(1,066)	(279)	(15)	(1,360)
Depreciation	(4,921)	(786)	(291)	(5,998)
Amortisation	(877)	(612)	(6)	(1,495)
Operating profit/(loss)	**5,610**	**1,940**	**(536)**	**7,014**
Finance costs				(886)
Tax				503
Retained profit				**6,631**
Segment assets				
Operating assets	137,040	30,226	4,510	171,776
Cash				2,773
Total assets				**174,549**
Segment liabilities				
Operating liabilities	(60,738)	(4,679)	(280)	(65,697)
Borrowings				(18,256)
Total liabilities				**(83,953)**
Other segmental information				
Capital expenditure - intangible assets	22,213	2,558	998	25,769
Capital expenditure - property, plant and equipment	31,717	1,336	3	33,056

Costs not directly attributable to a segment are allocated based on the proportion of revenue attributable to that segment.

Finance costs are not allocated to the segments because treasury is managed centrally.

2011	Wireless £'000	Photonics £'000	Electronics £'000	Total £'000
Income statement				
Revenue	55,156	18,551	1,611	75,318
EBITDA	**10,718**	**3,409**	**(172)**	**13,955**
Share based payments	(933)	(309)	(42)	(1,284)
Depreciation	(3,101)	(743)	(331)	(4,175)
Amortisation	(820)	(300)	(3)	(1,123)
Operating profit/(loss)	**5,864**	**2,057**	**(548)**	**7,373**
Finance costs				(481)
Tax				1,551
Retained profit				**8,443**
Segment assets				
Operating assets	73,108	24,930	3,352	101,390
Cash				3,233
Total assets				**104,623**
Segment liabilities				
Operating liabilities	(13,362)	(10,992)	(365)	(24,719)
Borrowings				(7,154)
Total liabilities				**(31,873)**
Other segmental information				
Capital expenditure - intangible assets	1,974	496	782	3,252
Capital expenditure - property, plant and equipment	15,604	1,549	235	17,388

In the periods set out below, certain customers, all within the Wireless operating segment, accounted for greater than 10% of the Group's total revenues:

	2012 £'000	2012 % revenue	2011 £'000	2011 % revenue
Customer 1	22,364	25%	1,804	2%
Customer 2	12,849	15%	14,848	20%
Customer 3	7,800	9%	7,491	10%

There are no customers in the photonics or electronics segments that accounted for greater than 10% of the Group's total revenues.

Geographical information

Disclosure of group revenues by location of customer:

	2012 £'000	2011 £'000
Americas	**64,967**	**49,848**
United States of America	64,425	48,498
Rest of Americas	542	1,350
Europe, Middle East & Africa (EMEA)	**5,721**	**7,494**
France	503	426
Germany	1,391	1,694
Israel	1,042	2,493
United Kingdom	1,439	821
Rest of EMEA	1,346	2,060
Asia Pacific	**17,273**	**17,976**
People's Republic of China	865	2,202
Japan	6,006	6,241
Taiwan	9,074	7,758
Rest of Asia Pacific	1,328	1,775
Total revenue	**87,961**	**75,318**

Disclosure of non-current assets by location of assets:

	Property, plant and equipment		Intangible assets	
	2012	2011	2012	2011
By location	**£'000**	**£'000**	**£'000**	**£'000**
USA	45,647	22,558	36,013	16,882
Singapore	11,167	9,262	9,041	8,843
UK	5,506	5,528	9,111	6,981
	62,320	**37,348**	**54,165**	**32,706**

4. Operating profit

	2012 £'000	2011 £'000
The operating profit is stated after charging/(crediting):		
Depreciation of property, plant and equipment	5,998	4,175
Amortisation of non-current intangible assets	1,495	1,123
Gain on sale of property, plant and equipment	-	(68)
Services provided by auditors	178	113
Operating lease rentals	2,511	2,158
Research and development	143	107
Exchange losses	(258)	26
Cost of inventories consumed	34,110	30,822
Exceptional items	570	-

A schedule of services provided by the group's auditors is disclosed in the Corporate Governance Report.

Exceptional items relate to the transaction costs expensed during the year in relation to acquisitions and debt and equity fund raising.

5. Employee costs

	2012 £'000	2011 £'000
Employee costs (including directors' remuneration)		
Wages and salaries	18,593	15,541
Social security costs	2,051	1,952
Other pension costs	904	729
Charge for share based payments	1,360	1,284
	22,908	**19,506**

	2012 Number	2011 Number
Average number of employees (including directors)		
Cost of sales	389	311
Selling, general and administrative	90	95
	479	**406**

Directors' emoluments and share option details are disclosed in the Remuneration Report. Key management within the group comprises the executive and non-executive directors and the general managers of the subsidiaries. Compensation to key management, including pensions of £83,000 (2011: £75,000), was £2,132,000 (2011: £1,987,000) and the charge for share-based payments was £230,000 (2011: £594,000).

6. Finance costs

	2012 £'000	2011 £'000
Bank and other loans	588	408
Finance lease interest	29	73
Unwind of discount on long term balances	269	-
	886	**481**

7. Taxation

Current tax credit	2012 £'000	2011 £'000
United Kingdom research and development tax credits receivable	501	568
Overseas taxes receivable/(payable)	10	(58)
Total current tax credit	**511**	**510**
Deferred tax (charge)/credit	(8)	1,041
Total tax credit	**503**	**1,551**

Factors affecting total tax credit

The tax credit assessed for the period is different from that resulting from applying the standard rate of corporation tax in the UK: 24.5% (2011: 26.5%). The differences are explained below:

	2012 £'000	2011 £'000
Profit on ordinary activities before taxation	6,128	6,892
Tax charge at 24.5% thereon (2011: 26.5%)	(1,501)	(1,826)
Effects of :		
Expenses not deductible for tax purposes	(63)	(48)
Overseas tax rate differences	375	530
Decrease/(Increase) in unrecognised tax losses	423	(1,008)
Other deferred tax movements	768	3,335
United Kingdom research and development tax credits receivable	501	568
Total tax credit for the year	**503**	**1,551**

On 21 March 2012 the UK Government announced a reduction in the rate of corporation tax to 24% with effect from 1 April 2012. In addition, the Finance Act 2012, which passed into law on 3 July 2012 included legislation to reduce the main rate of corporation tax from 24% to 23% with effect from 1 April 2013.

The proposed further reduction in the UK corporation tax rate by 2% to 21% from 1 April 2014 is expected to be enacted separately; the effect of this change on deferred tax cannot be reliably quantified at this stage.

Deferred tax asset	2012 £'000	2011 £'000
At 1 January	1,876	824
Deferred tax (expense)/credit recognised in the year	(8)	1,041
Deferred tax assets recognised on acquisition	13,188	-
Foreign exchange differences	(507)	11
At 31 December	**14,549**	**1,876**

The deferred income tax asset recognised at 31 December 2012 of £14,549,000 (2011: £1,876,000) relates mainly to timing differences on fair value adjustments in respect of the acquisition set out in note 17, as well as an element of tax losses carried forward and accelerated depreciation. These are recognised to the extent that the realisation of the related tax benefit through future taxable profits from the same trade is probable. The group currently benefits from a 0% tax rate on trading income arising in Singapore.

The net amount not recognised is an asset of £25,036,000 (2011: £26,691,000). Tax losses carried forward account for an asset of £31,228,000 (2011: £31,651,000). The remaining unrecognised amounts relating to a mix of temporary timing differences including accelerated depreciation and income tax deductions receivable on the exercise of employee share options. The asset would be recognised if sufficient profits from the same trade arise in future periods.

8. Dividends

No dividend has been paid or proposed in 2012 (2011: £nil).

9. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year.

Diluted earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of shares and 'in the money' share options in issue. Share options are classified as 'in the money' if their exercise price is lower than the average share price for the year. As required by IAS 33, this calculation assumes that the proceeds receivable from the exercise of 'in the money' options would be used to purchase shares in the open market in order to reduce the number of new shares that would need to be issued.

The directors also present an adjusted earnings per share measure which eliminates certain non-cash items in order to provide a more meaningful underlying profit measure. Specifically, the non-cash accounting charges eliminated are:

- financing charges relating to discounting of long term acquisition balances;
- amortisation of intangibles arising on acquisition;
- share based payments; and
- exceptional items.

	2012 £'000	2011 £'000
Profit attributable to ordinary shareholders	6,631	8,443
Exceptional items	570	-
Discounting of long term acquisition related balances	269	-
Amortisation of acquired intangibles	258	-
Share based payments	1,360	1,284
Adjusted profit attributable to ordinary shareholders	**9,088**	**9,727**

	2012 Number	2011 Number
Weighted average number of ordinary shares	571,972,538	522,386,930
Dilutive share options	29,715,163	37,008,723
Adjusted weighted average number of ordinary shares	**601,687,701**	**559,395,653**
Adjusted earnings per share	1.59p	1.86p
Earnings per share	1.16p	1.62p
Adjusted diluted earnings per share	1.51p	1.74p
Diluted earnings per share	1.10p	1.51p

10. Intangible assets

The Group	Goodwill £'000	Patents £'000	Development costs £'000	Software £'000	Acquisition intangibles £'000	Total £'000
Cost						
At 1 January 2012	19,823	305	16,098	942	-	37,168
Additions	-	88	4,042	219	17	4,366
NanoGaN adjustment (see below)	(478)	-	(600)	-	-	(1,078)
Acquisitions (note 17)	18,287	-	-	-	3,116	21,403
Foreign exchange	(1,267)	-	(458)	(1)	(171)	(1,897)
At 31 December 2012	**36,365**	**393**	**19,082**	**1,160**	**2,962**	**59,962**
Accumulated amortisation and impairment						
At 1 January 2012	-	26	4,092	344	-	4,462
Charge for the year	-	30	1,188	19	258	1,495
Foreign exchange	-	-	(145)	(3)	(12)	(160)
At 31 December 2012	**-**	**56**	**5,135**	**360**	**246**	**5,797**
Net book value						
At 31 December 2012	**36,365**	**337**	**13,947**	**800**	**2,716**	**54,165**
At 31 December 2011	19,823	279	12,006	598	-	32,706

The NanoGaN adjustment relates to the reduction in the estimated deferred consideration payable.

The Group	Goodwill £'000	Patents £'000	Development costs £'000	Software £'000	Acquisition intangibles £'000	Total £'000
Cost						
At 1 January 2011	19,674	222	13,097	697	-	33,690
Additions	-	83	2,924	245	-	3,252
Foreign exchange	149	-	77	-	-	226
At 31 December 2011	**19,823**	**305**	**16,098**	**942**	**-**	**37,168**
Accumulated amortisation and impairment						
At 1 January 2011	-	11	3,076	202	-	3,289
Charge for the year	-	15	966	142	-	1,123
Foreign exchange	-	-	50	-	-	50
At 31 December 2011	**-**	**26**	**4,092**	**344**	**-**	**4,462**
Net book value						
At 31 December 2011	**19,823**	**279**	**12,006**	**598**	**-**	**32,706**
At 31 December 2010	19,674	211	10,021	495	-	30,401

The amortisation charge of : £1,495,000 (2011: £1,123,000) has been charged to selling, general and administrative expenses in the Consolidated Income Statement.

The carrying value of deferred development costs continue to be supported by forecast cash flows.
The NanoGaN adjustment shown above relates to a reduction in the estimated deferred consideration payable.

Impairment tests for goodwill

Goodwill is allocated to the group's cash generating units (CGUs) identified according to operating segment. An operating segment level summary of the goodwill allocation is presented below:

	2012 £'000	2011 £'000
Allocation of goodwill by operating segment		
Wireless	29,379	12,070
Photonics	6,986	7,753
Total Goodwill	**36,365**	**19,823**

Multiple production facilities can be included in a single CGU reflecting that production can (and is) transferred between sites to suit capacity planning and operational efficiency.

The recoverable amount of all CGUs has been determined based on value in use calculations, using pre-tax cash flow projections for a five year period. The Board approved budget is used for the first year of the forecast. Beyond this the Board has used assumptions which are below expectations in order to "stress test" for potential impairment, namely : revenue growth 5% pa; margin erosion 1% pa, cost inflation 3%. A pre-tax discount rate of 11% (2011: 10%) has been used in these calculations, which management believe is appropriate for each CGU given that they have similar risk profiles and common funding.

Even on this "stressed" basis, there remains a significant level of headroom in the calculations. In addition, to test the sensitivity of the discount rate, if a 15% discount rate is used there is still no impairment of assets.

11. Property, plant and equipment

a) The Group	Land and buildings £'000	Short leasehold improve-ments £'000	Fixtures and fittings £'000	Plant and machinery £'000	Total £'000
Cost					
At 1 January 2012	6,393	11,284	2,398	112,248	132,323
Additions	15	225	107	12,709	13,056
Acquisitions (note 17)	-	13,032	-	6,968	20,000
Disposals	-	-	(2)	(228)	(230)
Foreign exchange	(110)	(887)	(54)	(3,090)	(4,141)
At 31 December 2012	**6,298**	**23,654**	**2,449**	**128,607**	**161,008**
Accumulated depreciation					
At 1 January 2012	2,802	9,955	2,133	80,085	94,975
Disposals	-	-	(2)	(228)	(230)
Charge for the year	151	799	104	4,944	5,998
Foreign exchange	(15)	(214)	(50)	(1,776)	(2,055)
At 31 December 2012	**2,938**	**10,540**	**2,185**	**83,025**	**98,688**
Net book value					
At 31 December 2012	**3,360**	**13,114**	**264**	**45,582**	**62,320**
At 31 December 2011	3,591	1,329	265	32,163	37,348

b) The Group	Land and buildings £'000	Short leasehold improve-ments £'000	Fixtures and fittings £'000	Plant and machinery £'000	Total £'000
Cost					
At 1 January 2011	6,344	10,762	2,387	100,130	119,623
Additions	12	925	143	16,308	17,388
Disposals	-	(685)	(184)	(4,810)	(5,679)
Foreign exchange	37	282	52	620	991
At 31 December 2011	**6,393**	**11,284**	**2,398**	**112,248**	**132,323**
Accumulated depreciation					
At 1 January 2011	2,646	10,444	2,202	80,527	95,819
Disposals	-	(685)	(184)	(4,788)	(5,657)
Charge for the year	149	168	97	3,761	4,175
Foreign exchange	7	28	18	585	638
At 31 December 2011	**2,802**	**9,955**	**2,133**	**80,085**	**94,975**
Net book value					
At 31 December 2011	**3,591**	**1,329**	**265**	**32,163**	**37,348**
At 31 December 2010	3,698	318	185	19,603	23,804

c) **Capitalised finance leases**

Plant and machinery includes the following amounts where the group is a lessee under a finance lease:

	2012 £'000	2011 £'000
Cost	2,576	-
Accumulated depreciation	(46)	-
Net book value	2,530	-

The group leases various plant and machinery assets under non-cancellable finance lease agreements. The lease terms are up to three years, and the ownership of the assets lie within the group.

12. Investments

a) Company

	Investments in subsidiaries £'000	Other equity investments £'000	Total £'000
Cost			
At 1 January 2012	84,125	-	84,125
Investment in Solar Junction Corporation (note 12b)	-	3,205	3,205
Adjustment to NanoGaN Limited deferred consideration (note 10)	(1,078)	-	(1,078)
Subsidiaries share based payments charge	329	-	329
At 31 December 2012	**83,376**	**3,205**	**86,581**
Accumulated amortisation			
At 1 January 2012 and 31 December 2012	**70,438**	**-**	**70,438**
Net book value			
At 31 December 2012	**12,938**	**3,205**	**16,143**
At 1 January 2012	13,687	-	13,687

	Investments in subsidiaries £'000	Other equity investments £'000	Total £'000
Cost			
At 1 January 2011	84,676	-	84,676
Adjustment to NanoGaN Limited deferred consideration	(750)	-	(750)
Subsidiaries share based payments charge	199	-	199
At 31 December 2011	**84,125**	**-**	**84,125**
Accumulated amortisation			
At 1 January 2011 and 31 December 2011	**70,438**	**-**	**70,438**
Net book value			
At 31 December 2011	**13,687**	**-**	**13,687**
At 1 January 2011	14,238	-	14,238

Details of principal subsidiaries are set out in note 24.

b) Group

On 8 February 2012, the Group (and Company) invested £3.2m for a 9% equity investment in Solar Junction Corporation ("SJC"), and contemporaneously entered into an exclusive long term supply contract to supply SJC with advanced semi-conductor materials for the Concentrated Photovoltaic Market. This investment is accounted for at cost of investment less provision for impairment on the basis that the Group (and Company) does not have the ability to exert significant influence or control over the strategic and operating activities of SJC.

13. Inventories

The Group	2012 £'000	2011 £'000
Raw materials and consumables	14,334	12,144
Work-in-progress and finished goods	4,017	2,978
	18,351	**15,122**

The directors are of the opinion that the replacement values of inventories are not materially different to the carrying values stated above. These carrying values are stated net of impairment provisions of £1,781,000 (2011: £1,989,000).

14. Trade and other receivables

	2012 Group £'000	2012 Company £'000	2011 Group £'000	2011 Company £'000
Trade receivables	9,870	-	7,244	-
Amounts owed by group undertakings	-	56,251	-	45,991
Other receivables and prepayments	9,316	141	7,094	143
	19,186	**56,392**	**14,338**	**46,134**

As at 31 December 2012, 93% (2011: 82%) of trade receivables were within terms. Of the other trade receivables, 64% (2011: 87%) were less than 30 days past due. An allowance has been made for estimated irrecoverable amounts from the sale of goods of £79,000 (2011: £135,000). This allowance has been determined by reference to past default experience. Included in other receivables is accrued income of £7,375,000 (2011: £4,531,000).

The carrying values of trade and other receivables also represent their estimated fair values.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable as set out above. In terms of trade receivables, the terms of sale provide that the group has recourse to the products sold in the event of non-payment by a customer.

Trade receivables and accrued income are primarily denominated in US dollars, as are trade payables (note 15). The natural hedge between these financial instruments limits the exposure of the group to movements in foreign exchange rates. Based on the balances held at 31 December 2012 a 1 cent movement in the US dollar to Sterling rate would impact the net value of these instruments by £11,000 (2011: £6,000) (before the mitigating impact of cash flow hedges).

15. Trade and other payables

Current	2012 Group £'000	2012 Company £'000	2011 Group £'000	2011 Company £'000
Trade payables	16,046	-	11,630	-
Deferred consideration (note 17)	10,000	-	6,080	-
Other taxation and social security	316	139	307	63
Forward foreign exchange contracts (cash flow hedge)	-	-	246	246
Accruals and deferred income	5,347	545	4,894	1,428
	31,709	**684**	**23,157**	**1,737**

Non-current	2012 Group £'000	2012 Company £'000	2011 Group £'000	2011 Company £'000
Deferred consideration (note 17)	**34,386**	**484**	**1,562**	**1,562**

Within deferred consideration is £43.9m being the best estimate of the amount that will be settled through contractually agreed price discounts over the next four years (as set out in note 17).

The carrying values of trade and other payables also represent their estimated fair values.

Forward foreign currency exchange contracts are designated as cash flow hedges against highly probable forecast transactions denominated in US dollars that are expected to occur at various dates. The amount recognised within payables represents the mark to market value of these contracts at each reporting date. Movements in the mark to market value are included within other comprehensive income and other reserves within equity.

16. Borrowings

The Group	2012 £'000	2011 £'000
Non-current borrowings:		
Bank loans	14,094	7,087
Finance leases	1,734	18
	15,828	**7,105**
Current borrowings:		
Bank loans	1,687	-
Finance leases	741	49
	2,428	**49**
Total Borrowings	**18,256**	**7,154**

a) Bank loans

	2012	2011
	£'000	£'000
Bank Borrowings fall due for repayment as follows:		
Within one year	1,687	-
Between one and five years	14,094	7,087
After five years	-	-
	15,781	**7,087**

The group's bank loans consist of a series of variable and fixed rate term loans, and a revolving credit facility.

The variable rate term loans, which had principle outstanding at 31 December 2012 of £4.1m (2011 : £nil), bear interest of between 2.0% to 2.5% over LIBOR. These loans are repayable by monthly installment with remaining terms of up to 4 years.

The fixed rate term loans, which had principle outstanding at 31 December 2012 of £2.1m (2011 : £nil), bear interest of 5% until 2017 and is variable thereafter. These loans are repayable by monthly installment with remaining terms of up to 20 years.

The revolving credit facility is a multi-currency facility of up to £21 million, committed until 2016. It bears interest of between 1.75% to 1.95% over LIBOR. The balance drawn at 31 December 2012 was £9.6m (2011 : £7.1m).

Bank loans are secured against the assets of the group.

The carrying value of loans approximates to their fair value based on the net present value of future cash flows.

As disclosed in note 25, on 10 January 2013 the group raised $40m of acquisition finance to part fund the acquisition of Kopin Wireless.

b) Finance leases

	2012	2011
	£'000	£'000
Gross finance lease liabilities – minimum lease payments:		
Within one year	813	50
Between one and five years	1,803	19
	2,616	69
Finance charges	(141)	(2)
Present value of finance lease liabilities	**2,475**	**67**

	2012	2011
	£'000	£'000
Present value of finance lease liabilities:		
Within one year	741	49
Between one and five years	1,734	18
	2,475	**67**

Lease liabilities are effectively secured as the rights to the leased asset reverts to the lessor in the event of default.

The company

The borrowings of the parent company comprise the bank loan of £9,565,000 (2011 £7,087,000) which is denominated in US dollars (2011: £700,000 was denominated in sterling and the remainder was denominated in US Dollars). This amount is repayable between two and five years (2011: repayable between two and five years).

17. Business combination

On 11 June 2012 the group acquired the in-house epitaxy operation of a leading wireless chip manufacturer. Under the terms of this trade and assets deal, the Group acquired the leasehold production facility, the production equipment and related inventories; assumed employment of the workforce; and entered into a long term supply contract. The consideration for the acquisition is being settled entirely via a contractually agreed price discount on future product sales to the vendor until 2016.

The comparison of book value to fair value is summarised as follows:

	Book value	Fair value Adjustment	Fair value
	£'000	£'000	£'000
Intangible assets	-	3,116	3,116
Property plant and equipment	17,400	2,600	20,000
Inventory	1,001	-	1,001
Deferred tax asset	-	13,187	13,187
Goodwill	-	18,287	18,287
Total contingent deferred consideration	**18,401**	**37,190**	**55,591**

The fair value of the intangible assets represents the estimated fair value of the supply contract, and has been assessed based on an imputed royalty stream to recover the estimated cost of product development and qualifications to which the contract relates.

The fair value of the property plant and equipment has been estimated on a depreciated replacement cost basis, using internal and external cost data. Inventory has been recognised at the lower of cost and net realisable value.

Deferred tax has been recognised in respect of temporary timing differences between the accounting and tax treatments for the assets and liabilities recognised.

Goodwill reflects items not separately recognisable under IFRS, and largely reflects financial and operational synergies of the enlarged group including improved economies of scale and equipment utilisation.

The fair value of the consideration has been estimated based on expected future sales volumes and price discounts. Sales are recorded at their fair value, but billed at the contractually agreed discounted rate. The discount on each sales transaction is accounted for as a reduction in the contingent deferred consideration balance. As a guide to the sensitivity of this estimate, if actual volumes were 5% lower than the estimated future volumes then the total consideration would reduce by approximately £2.8m.

The fair values for intangibles assets and consideration are provisional fair values, and as long term balances have been discounted at discount rate of 1%.

Acquisition related costs of £0.1m have been charged to administration expenses in the consolidated income statement for the year ended 31 December 2012.

Prior to acquisition this business was part of a larger internal manufacturing process, and therefore a separate trading account is not available. Post acquisition this business unit contributed revenue of £20m, and profit after tax of £4m to the Consolidated Income Statement. Management believes that it would be impracticable to extrapolate a trading result for a full year 2012 due to the impact of changes in inventory levels in the supply chain.

The purchase agreement provided that the consideration for the acquisition is settled via a contractually agreed price discount on product sales to the vendor until 2016. Accordingly, the total consideration payable is entirely contingent on future sales, and has been estimated at £54.6 million based on the expected future volumes and price discounts. The revenue on these product sales is recognised at their full market value but billed net of the contractual discount, hence the operating cash flow is inherently lower than the operating profit during the discount period. The value of the discount in 2012 was £8.4m (2011 : nil).

If the purchase agreement had provided for the sales to be billed and settled at full market value, and for the purchase consideration to be paid to the vendor in cash ("Gross basis"), then the operating cash generated from the trade would have been reported at the higher value, and the purchase consideration paid would have been classified as an investing activity. Assuming no other changes to the terms of trade (including volumes, timing and pricing) then under the Gross basis there would be no impact on the Consolidated Balance Sheet or Income Statement, however the cash flow presentation would have been impacted as follows:

£'000	As currently reported	Impact	Gross basis
Net cash generated from operating activities	4,777	8,379	13,156
Net cash used in investing activities	(26,159)	(8,379)	(34,538)

18. Share capital

Group and Company	2012 Number of shares	2012 £'000	2011 Number of shares	2011 £'000
Allotted, called up and fully paid				
Ordinary shares of 1p each	588,215,751	5,882	525,111,639	5,251

The movement in the number of ordinary shares during the year was:

	2012 Number	2011 Number
At 1 January	525,111,639	515,327,055
Employee share schemes	19,336,112	9,804,267
Placing	43,768,000	-
At 31 December	**588,215,751**	**525,111,639**

63,104,112 ordinary shares (2011: 9,784,584 ordinary shares) were issued during the as follows:

	2012 Number of shares	2012 Consideration	2011 Number of shares	2011 Consideration
Employee share schemes	19,336,112	Nil cost to 52.08p	9,784,584	Nil cost to 52.08p
Placing	43,768,000	24.00p	-	-
	63,104,112		**9,804,267**	

The group's objectives when managing capital are to safeguard the entity's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders.

The group sets the amount of capital in proportion to risk. The group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the characteristic of the underlying assets. The group monitors capital by reviewing net debt against shareholders' funds. The position of these indicators and the movement during the period is shown in the Five Year Financial Summary and on page [18] of the Directors' Report.

19. Share based payments

The total amount charged to the income statement in 2012 in respect of share based payments was £1,360,000 (2011: £1,284,000).

Share option scheme

The IQE Plc Share Option Scheme was adopted on 26 May 2000 and amended by shareholders at the Annual General Meeting on 17 May 2002. Under the scheme, the Remuneration Committee can grant options over shares in the company to employees of the group.

Options are granted with a contractual life of ten years and with a fixed exercise price equal to the market value of the shares under option at the date of grant or as otherwise disclosed in the remuneration report. Options become exercisable between one and four years from the date of grant subject to continued employment and the achievement of performance conditions, including growth in EBITDA and earnings per share against various targets. The group has no legal or constructive obligation to repurchase or settle the options in cash.

Options are valued using the Black-Scholes option-pricing model and the total amount to be expensed is charged to income statement over the vesting period of the option. The principal assumptions used in the calculation of the fair value of share options are as follows:

Principal assumptions	2012	2011
Weighted average share price at grant date	**27.75p**	22.35p
Weighted average exercise price	**6.40p**	22.88p
Weighted average vesting period (years)	**3**	3
Option life (years)	**10**	10
Weighted average expected life (years)	**3**	3
Weighted average expected volatility factor	**61%**	72%
Weighted average risk free rate	**0.37%**	0.90%
Dividend yield	**0%**	0%

The expected volatility factor is based on historical share price volatility over the three years immediately preceding the grant of the option. The expected life is the average expected period to exercise. The risk free rate of return is the yield of zero-coupon UK government bonds of a term consistent with the assumed option life.

Performance conditions are incorporated into the calculation of fair value by estimating the proportion of share options that will vest and be exercised based on a combination of historical trends and future expected trading performance. These are reassessed at the end of each period for each tranche of unvested options.

The fair value of options granted during the year ended 31 December 2012 was £1,521,920 (2011: £373,263).

The movements on share options during the year were as follows:

	2012 Number of options	2012 Average exercise price (pence)	2011 Number of options	2011 Average exercise price (pence)
At 1 January	51,043,125	10.14	58,617,656	8.96
Granted	9,471,944	6.40	5,889,277	22.88
Exercised	(17,702,729)	8.88	(8,943,919)	6.88
Cancelled/lapsed	(4,118,826)	7.11	(4,519,889)	17.95
At 31 December	**38,693,514**	**10.12**	**51,043,125**	**10.14**

The weighted average share price at the time of the options exercised during 2012 was 25.51p (2011: 46.91p).

As at 31 December 2012, the total number of options held by employees was 38,693,514 (2011: 51,043,125) as follows:

Option price pence/share	Option period ending	2012 Number of options	2011 Number of options
1.00p – 86.20p	31 December 2012	-	1,475,469
5.63p - 10.17p	31 December 2014	1,234,318	6,272,579
6.87p - 10.25p	31 December 2015	704,856	934,352
10.40p - 19.42p	31 December 2016	1,850,638	8,032,500
0.00p - 19.42p	31 December 2017	5,380,791	5,625,175
16.10p - 16.10p	31 December 2018	247,029	508,221
0.00p - 17.07p	31 December 2019	8,619,521	10,269,732
0.00p – 45.58p	31 December 2020	6,879,449	12,035,820
9.15p – 50.25p	31 December 2021	6,060,154	5,889,277
0.00p – 86.19p	31 December 2022	7,716,758	-
At 31 December		**38,693,514**	**51,043,125**

20. Parent company profit and loss

As permitted by Section 408 of the Companies Act 2006, the income statement of the parent company is not presented as part of these financial statements. The parent company's profit for the financial year amounted to £1,974,000 (2011: profit £1,243,000).

21. Cash generated from operations

The Group	2012 £'000	2011 £'000
Operating profit	7,014	7,373
Depreciation of property, plant and equipment	5,998	4,175
Amortisation of intangible assets	1,495	1,123
Gain on sale of property, plant and equipment	-	(68)
Contingent deferred consideration (settled through contractual discounts)	(8,379)	-
Share based payments	1,360	1,284
Cash inflow from operations before changes in working capital	**7,488**	**13,887**
Increase in inventories	(3,030)	(3,087)
(Increase)/decrease in trade and other receivables	(5,924)	2,033
Increase/(decrease) in trade and other payables	5,575	(2,010)
Cash inflow from operations	**4,109**	**10,823**

The Company	2012 £'000	2011 £'000
Operating loss	(927)	(924)
Share based payments	1,031	1,085
Cash (outflow)/inflow from operations before changes in working capital	**104**	**161**
Increase in trade and other receivables	(10,258)	(8,170)
Decrease in trade and other payables	(563)	(444)
Cash outflow from operations	**(10,717)**	**(8,453)**

22. Reconciliation of net cash flow to movement in net debt

	2012 £'000	2011 £'000
Decrease in cash in the year	(443)	(9,284)
Loans received	(10,877)	(7,267)
Loans repaid	1,335	5,777
Leases repaid	48	1,156
Net movement resulting from cash flows	**(9,937)**	**(9,618)**
Net (debt)/funds at 1 January	(3,921)	7,021
Net movement resulting from cash flows	(9,937)	(9,618)
Non-cash movements	(1,625)	(1,324)
Net debt at 31 December	**(15,483)**	**(3,921)**

23. Analysis of net debt

	At 1 January 2012 £'000	Cash flow £'000	Other non-cash movements £'000	At 31 December 2012 £'000
Cash and cash equivalents	3,233	(443)	(17)	2,773
Loans due after one year	(7,087)	(7,855)	848	(14,094)
Loans due within one year	-	(1,687)	-	(1,687)
Finance leases due after one year	(18)	18	(1,734)	(1,734)
Finance leases due within one year	(49)	30	(722)	(741)
Total borrowings	(7,154)	(9,494)	(1,608)	(18,256)
Net debt	**(3,921)**	**(9,937)**	**(1,625)**	**(15,483)**

Cash and cash equivalents at 31 December 2012 comprised balances held in instant access bank accounts.

Non-cash movements include the drawdown of a finance lease and foreign exchange movements on US dollar denominated borrowings.

24. Principal subsidiary undertakings

Name of company	Class of capital	Proportion of shares held	Activity	Country of incorporation
IQE (Europe) Limited	Ordinary shares of £1	100%*	Manufacture of advanced semiconductor materials	UK
IQE Inc	Common stock of $0.001	100%*	Manufacture of advanced semiconductor materials	USA
IQE RF LLC	Limited liability company	100%	Manufacture of advanced semiconductor materials	USA
IQE Silicon Compounds Limited	Ordinary shares of £1	100%	Manufacture of silicon epitaxy	UK
MBE Technology Pte Ltd	Preferred shares of S$1 Ordinary shares of S$1	100% 100%	Manufacture of advanced semiconductor materials	Singapore
Wafer Technology Limited	Ordinary shares of £1	100%*	Manufacture of semiconductor compounds and ultra high purity materials	UK
NanoGaN Limited	Ordinary shares of £0.001	100%	Development of advanced semiconductor materials	UK
Galaxy Compound Semiconductors Inc	Common stock of $0.00 par value	100%*	Manufacture of semiconductor compounds	USA

* Indirect holdings

* The proportion of voting rights of subsidiaries held by the group is the same as the proportion of shares held.

25. Post balance sheet event

On 15 January 2013, IQE plc completed the acquisition of the Kopin Wireless, the compound semiconductor epiwafer manufacturing business of Kopin Corporation ("Kopin"), a NASDAQ listed entity.

The consideration for the acquisition was $75m, of which $60m was paid in cash on completion, and $15m falls payable in January 2016.

The assets acquired were the trade and assets of Kopin Wireless' US domiciled business, which operates from a long leasehold premises located in Massachusetts USA; and its 90% equity stake in its Taiwanese subsidiary (KTC), which operates from a freehold premises in Hsinchu Taiwan.

This acquisition brings a number of strategic advantages to IQE, including :

- a HBT business to complement IQE's existing pHEMT business;
- greater customer diversity to help mitigate against the impact of changes in market share between customers;
- expands IQE's Asian footprint, providing improved access to the growing Asian market;
- improved economies of scale; and
- providing access to significant expected cost synergies.

The upfront consideration of $60 million was part financed by $40 million of acquisition finance provided by HSBC. The balance was financed from the proceeds of a placing of 56,900,961 new ordinary shares at 29.00p. The deferred consideration of $15 million will be settled through future cash generation.

26. Related party transactions

The group incurred professional fees and expenses during the year of £70,000 (2011: £70,000) payable to Horton Corporate Finance and £35,000 (2011: £35,000) payable to Fishstone Limited. Dr G H H Ainsworth, who is a director of IQE Plc, is a director of Horton Corporate Finance. S J Gibson, who is a director of IQE Plc, is also a director of Fishstone Limited. An amount of £26,000 (2011: £26,000) was outstanding to these parties at the year-end. The group incurred professional fees and expenses during the year of £12,000 (2011: £nil) payable to Dr D Grant which remains outstanding at year end.

27. Operating lease commitments

The group was committed at 31 December 2012 and 31 December 2011 to making the following aggregate payments in respect of non-cancellable operating leases:

	2012	2011
	£'000	£'000
Due within one year	2,062	2,130
Due between two and five years	7,440	6,833
Due after five years	9,065	10,337
	18,567	**19,300**

28. Commitments

The group had the following capital commitments at 31 December 2012 and 31 December 2011:

	2012	2011
	£'000	£'000
Authorised and contracted for	**-**	**243**

Officers and professional advisers

IQE plc is a public limited company incorporated in England and Wales.

Directors
Dr G H H Ainsworth BSc, Ph.D, FCA (Chairman, Non-Executive)
Dr A W Nelson OBE, BSc, Ph.D, FREng (President and Chief Executive Officer)
Mr S J Gibson OBE (Non-Executive)
Dr David Grant CBE, FREng, FLSW, CEng, FIET (Senior Independent Director, appointed 18 September 2012)
Mr P J Rasmussen BSc, ACA (Finance Director and Company Secretary)
Dr H R Williams BSc, Ph.D, CEng, MIMechE, MCIBSE (Operations Director)
Mr A G Meldrum (Business Development Director, resigned 21 September 2012)

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