BOOKHAM® technology

The Power of Integration

Annual report 2001

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SUMMARY

Vision Statement

Bookham Technology designs, manufactures and markets integrated optical components using high volume production methods. With patented silicon-based ASOC, Gallium Arsenide and Indium Phosphide technologies, we can supply end-to-end networking solutions that offer higher performance, lower cost and provide greater systems capability to communications network system providers.

Our vision is to be the world leading provider of multi-functional integrated active and passive optical modules and subsystems.

2001 at a glance

- Continued focused restructuring to respond to industry downturn
  - headcount cut 38% from January peak
  - quarterly cash burn cut 50%
- Strong cash position with £184.8 million in bank
- Maintained strong design-in R&D efforts
- Product enhancements and new products introduced
- Enhanced technology position—three functions on a chip
- Strengthened management team
- Acquisition of Marconi's optical components business

CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S STATEMENT

"Maintaining our direction in a difficult year for the industry, focusing on design-in efforts, enhancing our product portfolio, reducing our quarterly cash burn and preserving our strong cash position."

Bookham's ambition is to become a world-leading provider of integrated multi-functional optical components and subsystems to major communication network manufacturers. The year 2001, saw us advance in this direction and prepare for future growth when market conditions improve.

We experienced a challenging market as the downturn in the telecommunications industry continued. With sharply deteriorating demand throughout the year, we focused on restructuring the company, reducing our quarterly cash burn and preserving our strong cash position. However, we also focused on maintaining strong design-in efforts with key customers and the development of enhanced products to strengthen our position.

Products and customers

Throughout the year, we continued to invest in R&D in response to demand from lead customers. We to customize our products to work with, and be designed into, their specific systems—known as design-ins. Several product introductions were made in 2001 and strong interest from our customers further validated our belief in ASOC as the premier platform for the integration of complex optical functions onto a single optical chip. We have moved from products using silicon chips with a single optical function, such as the arrayed waveguide grating (AWG) or the electronic variable optical attenuator (EVOA), to products with two optical functions on a chip such as the Mux-VOA module, to products with three levels of optical functionality on a single silicon chip with the optical channel monitor with switched input.

This product combines switching, demultiplexing and detecting on a single chip and is capable of analysing optical power levels in over 400 channels at up to 40 Gb/s. In November, we announced that these modules were being evaluated in Nortel Network's next generation long-haul transmission systems. We believe this product is the most integrated single-chip optical product on the market today.

The Mux-VOA (integrated multiplexer and electronic variable optical attenuator), for which a design-in with Lucent Technologies was announced in the fourth quarter 2000, was upgraded to double its attenuation capabilities.

In January 2001, we signed an agreement to supply new extended-reach single-fibre transceivers to Fujitsu Telecommunications Europe. In the third and fourth quarters of 2001, Fujitsu in Japan and NEC were 10% customers on the basis of these transceiver products.

The electronic variable optical attenuator (EVOA) product line, aimed at the metropolitan market, was extended to include one-channel and eight-channel versions.

Restructuring

In reaction to the weaker market conditions in 2001, over the course of year we successfully reduced our cash burn by 50%, and also reduced employee headcount by 38% from the January peak. Given current market conditions, restructuring pressures have continued into the first quarter of 2002. At the same time, we continue to focus our investments to support the development of our ASOC technology and our newly-acquired lasers and modulators technology.

Management and personnel

During the year, we implemented a number of changes to the responsibilities and members of the senior management team to support plans to increase further the effectiveness of the group and corporate efficiency.

In February, Giorgio Anania was appointed to Chief Executive Officer, in addition to his responsibilities as President. Andrew Rickman, the group's founder, who had previously performed a combined role of Chairman and Chief Executive Officer, continued as Chairman.

In October, the group appointed Steve Abely as Chief Financial Officer and Steve Turley as Chief Commercial Officer. Both bring many years of experience in their respective areas.

With regard to non-executive directors, Graham Miller retired from the board at the end of 2001 and the board would like to thank him for his valued contribution over the past six years. We then welcomed Joe Cook to the board in February 2002 and we look forward to benefiting greatly from Joe's wealth of industry experience.

We are aware that our success depends on the skill and commitment of our employees and thank them for their hard work during the year.

Marconi's Optical Components Business

In December, we announced the acquisition of Marconi's optical components business (MOC). It is our belief that MOC has one of the strongest technical capabilities in the world for active optical components, particularly next-generation high-speed tunable lasers and Gallium Arsenide (GaAs) modulators. We believe this is an important acceleration towards us achieving our goal of becoming the leading global provider of integrated optical circuits and subsystems.

Today, our company has a leading technical position in all three major semiconductor technologies relevant to the field of optics: Silicon, Indium Phosphide, and Gallium Arsenide. Our product line-up has been broadened to include most of the key components required for next-generation DWDM (dense wavelength division multiplexing) networks. We anticipate our customers will require fewer suppliers, with a broader product line-up, and more highly integrated subsystems incorporating both active and passive optical functionality. Combining our integrated silicon optical chips with our tunable lasers and low-cost GaAs modulators will enable us to provide these fuller solutions.

We believe 2002 will be a year of revenue recovery for the company. We believe we are starting the year with all the key components required for next-generation optical networks. We will be completing the qualification of various products designed into customer platforms and moving them to the stage of volume commercial sales. We must initially sell our active and passive (ASOC) products independently. We must then design products to work together, moving to supplying optimised subsystems. Finally we must move to introduce ever more highly integrated products leveraging all our technologies and providing significant cost reduction opportunities for our customers. If we execute on this strategy, we are convinced we are well positioned for the market upturn.

Andrew Rickman

Andrew Rickman

Giorgio Anania

Giorgio Anania

ACQUISITION OF MARCONI'S OPTICAL COMPONENT BUSINESS

At Bookham Technology, our vision has always been to have our products inside all optical networking systems throughout the world and to be the world-leading provider of multi-functional integrated active and passive optical modules and subsystems.

In December 2001, the acquisition of Marconi's optical components business dramatically accelerated our integration strategy and significantly broadened our product portfolio.

The transaction was an all-share offer, which was completed on 1 February 2002, following shareholder approval. The shares offered represented approximately 10% of our outstanding share capital and were valued at approximately £16.4 million ($23.8 million) at the time of completion.

A key component of the transaction is the supply agreement which we entered into with Marconi as part of the acquisition, under it, Marconi has committed to purchase a minimum of £30 million ($43.5 million) of products over 18 months. This agreement both increases our expected revenues for 2002 and gives us more visibility at a time when market conditions continue to be difficult to predict.

This acquisition is an important step. MOC's products include fixed-wavelength lasers, narrow-band and wide-band tunable lasers, high speed receivers and drivers, and erbium doped fibre amplifiers (EDFAs), operating at speeds between 10 Gb/s and 40 Gb/s. By integrating MOC's world-class active optical components with our own integrated passive solutions, we believe that we will be able to accelerate the development of more highly integrated optical components. In addition, our product portfolio will be extended and we will be able to provide complete end-to-end capability, combining active and passive components to provide integrated network solutions across the full optical communications platform.

MARKET AND CUSTOMERS

2001 was a very challenging market as the industry declined further. It is apparent that the downturn will continue during 2002, although external sources are predicting the resumption of growth thereafter. However, despite the reduction in the overall market, there remains for us, a big opportunity as we can still have a large impact and influence on the currently depressed market. In addition, our renewed focus on our overall cost base will help us significantly in the longer term.

Customer requirements are becoming clearer: they need to reduce the number of suppliers, cut costs and they will require their suppliers to take a solutions approach in designing and manufacturing optical products. We are now in a position to offer more to our existing customers, as well as to a new set of customers who need increasing capabilities from a single optical component supplier.

Our customers include some of the world's major optical communication network manufacturers and our products are designed into network systems which are used by communication services providers. The top six network equipment manufacturers account for 80% of the total world market and of these, four are announced Bookham customers.

As an active development partner, we work closely with our customers to provide innovative component solutions. It is vital that we maintain our relationships with our key customers at every stage in the development process from concept to design, prototyping and delivery. As part of our customer service strategy, we also offer application support to assist customers with the design-in process.

We continue to invest in R&D in response to demand for design-in work from lead customers for next-generation networks. In addition, we are planning to extend our position by further penetration of high value adding products to existing customers and targeting of key potential customers.

PRODUCTS AND TECHNOLOGY

We believe that we now have all of the key semiconductor technologies under one roof. Our new capabilities in automated mass production of both GaAs and InP optical ICs complement our existing investment in silicon optical circuits to produce one of the industry's most comprehensive product portfolios.

We believe we have unrivalled expertise in integration, which we expect to drive down costs, and we have the systems-level understanding to deliver real solutions to our customers. The solutions approach means that optical component suppliers need to be able to call upon a diversity of technologies to achieve the project. In the near-term, this will increasingly mean creating optical modues which perform a range of functions. In time, these could evolve into integrated optical chips, as technology progresses.

During 2001, we enhanced our product range with the introduction of the three-function optical channel monitor with switched input, combining switching, demultiplexing and dectecting on a single silicon chip. Further developments in the product platform included:

- Arrayed waveguide gratings (AWGs) with integrated electronics
- one-channel and eight-channel electronic variable optical attenuators (EVOA's)
- Extended-reach single-fibre transceivers aimed specifically at the Pacific Rim area.

For 2002, in the transmit/receive portion of the network, our extended portfolio includes fixed and tunable lasers, high speed gallium arsenide modulators, transmitters and receivers. Our silicon-based integrated transmitters and receivers are already widely deployed in FTTX systems, and the new products extend our reach into high-speed core networking and metro applications.

Tunable InP lasers form the core of the transmitter offering, with a wide tuning range to allow the entire ITU C-band to be covered with a single laser, cutting inventory costs and increasing manufacturing flexibility, particularly for designers of metro systems. GaAs modulators, integrated into a single package with either fixed or tunable lasers, provide a cost-effective yet advanced solution for integrated transmission systems.

Looking deeper into the network, our established integrated multiplexer and variable optical attenuator (Mux-VOA) continues to be a key component in WDM systems, combining the transmitted wavelengths and balancing channel power density in one package.

Established EDFA products join existing channel monitoring modules giving us a firm foothold in the core transport area of the network.

At the demultiplexing end of the system, our AWG-based demultiplexer combines with its versatile EVOA solution (which is also used in conjunction with EDFAs for channel-balancing applications) as the precursor to final reception of the signal, and as the core of add-drop functions in the transport portion of the network. In addition, we have a full range of solutions for final detection and termination of the signal, with 10 Gb/s and 40 Gb/s receivers and integrated transceiver modules.

SENIOR MANAGEMENT TEAM

Dr Andrew Rickman OBE PhD MBA, 42, Chairman and Director

Andrew Rickman was Chief Executive Officer and President from the time he founded Bookham Technology in 1988 and became Chairman in August 2000. Previously, he was with GenRad, where he worked in applications engineering and product management. In 2001 he received an Honorary Doctorate of Technology from Kingston University and was also awarded an Honorary Doctorate of the University of Surrey. During 2000 he was awarded an OBE for services to telecommunications.

Dr Giorgio Anania PhD, 43, Chief Executive Officer and Director

Giorgio Anania joined Bookham Technology as Senior Vice President Sales and Marketing in 1998 and was appointed President in August 2000 and CEO in February 2001. He was previously Vice President for Sales, Marketing and Business Development at Flamel Technologies, a French medical equipment company, which he helped take public on NASDAQ. Previously he was Strategic Marketing Manager for Telecom at Raychem in California, where he created one of the US's first DSL businesses. Giorgio also spent several years as a strategy consultant at Booz Allen in New York.

Steve Abely BA, 44, Chief Financial Officer

Steve Abely joined the Group in October 2001 as Chief Financial Officer. He has over 20 years' experience including senior financial positions in various US technology companies, and brings with him a good knowledge of US financial markets and a record in management of rapid growth business environments. Previously, he was CFO of Arescom Technology, a private broadband access equipment provider, based in California. From 1994 to 1999 he was first CFO and then President of StorMedia, a component supplier to the disc drive industry.

Dr Steve Turley BA MA PHd, 48, Chief Commercial Officer

Steve Turley joined the Group in October 2001 as Chief Commercial Officer. He was formerly Vice President, Strategic Partnerships with Nortel Network's High Performance Optical Component

Solutions Group, he is responsible for the entire commercial and product side of the company, driving its overall product strategy and taking leadership of the sales, marketing, product management and business development teams. Steve has over 25 years' experience in the optoelectronics and telecommunications industry world-wide.

Philip Davis MA, 36, General Counsel and Company Secretary

Philip Davis joined Bookham Technology in January 2001. He was previously Senior Legal Counsel at Imperial Chemical Industries plc, which he joined in 1996. Philip trained and qualified as a Solicitor with the law firm Rowe & Maw.

NON-EXECUTIVE DIRECTORS

Prof David Simpson CBE FRSE FIWW DSc, 75, Vice Chairman

David Simpson joined the board as Chairman in 1995. He became Vice Chairman in August 2000. Before joining Bookham Technology, he was President, from 1976 to 1986, of Gould Corporation in Chicago, US. David is a director of a number of private companies.

Lori Holland BS(Econ), 44

Lori joined the board in 1999, having previously been the Chief Financial Officer of Zaffire, Inc., NeoMagic Inc., and Read-Rite Corporation. She has served as a consultant to various technology startups and is on the Board of Directors of the Valley Medical Center in Silicon Valley.

Dr W. Arthur Porter PHD FIEE, 60

Skip Porter joined the board in 1998. He is currently the Southwestern Bell Chair Dean of Engineering and University Vice President for Technology Development at the University of Oklahoma. He was previously President and Chief Executive Officer of Houston Advanced Research Center. He was awarded the Institute of Electrical and Electronics Engineers' Centennial Medal for extraordinary achievement.

Jack St Clair Kilby MS(EE) MNAE, 78

Jack Kilby was appointed to the board of Bookham Technology in January 2000. In December 2000 Jack shared the Nobel Prize in Physics for his work on the invention of the integrated circuit. He was awarded the US National Medal of Science in 1970 and is an inductee in the US National Inventors Hall of Fame.

Robert Rickman MA MSc, 44

Robert Rickman was on the board of Bookham Technology from 1988 to 1990 and was re-appointed in 1994. He is a director of Highland Timber PLC and a number of private companies. He is the brother of Andrew Rickman.

Joseph Cook MBA, 50

Joe Cook joined the board in February 2002. He is Senior Vice President of Network Systems Engineering at WorldCom global network. Prior to joining MCL in 1979, he was a communications engineer for the Bechtel Corporation. He is an active member on two advisory boards for the University of Texas at Dallas as well as for Oklahoma State University.

FINANCIAL REVIEW

Year Ended 31 December 2001

All US dollar numbers have been translated at £1 = $1.45 for the convenience of the reader.

The results under US and UK GAAP are substantially the same, differences only are presented.

Revenues: Revenues for 2001 were £21.9 million ($31.8 million), down 17% from £26.3 million ($38.1 million) in 2000 as a result of the overall industry decline. Nortel Networks and Marconi plc were over 10% customers, representing 40% and 15% of revenue for the year respectively. On the product side DWDM products accounted for 28% and active products for 72% of revenue for the year.

Operating loss (before exceptional items): The gross loss (loss at the gross margin level) under UK GAAP increased 49% from £5.5 million ($8.0 million) in 2000 to £8.3 million ($12.0 million) in 2001, principally as a result of the declining revenue and the impact the high fixed cost base and low production volumes partially offset by reduction in overhead costs. In 2001, the Group employed additional personnel and increased capital resources committed to research and development efforts particularly focusing on DWDM products. As a result, operating expenses increased 60% from £33.1 million ($48.0 million) in 2000 to £53.1 million ($77.0 million) in 2001.

Restructuring charges (exceptionals for UK GAAP and one-time charges for US GAAP): Net exceptional charges under UK GAAP were £62.8 million ($91.1 million) in 2001. There were no exceptional charges in 2000. Of this, £22.3 million ($32.3 million) was to write-off goodwill and other intangibles relating to the acquisition of Measurement Microsystems arising from the Group's decision to discontinue development efforts and close the operation. For the year, the Group also wrote down £28.9 million ($41.9 million) of equipment considered excess and took provisions for excess inventory and purchasing commitments of £4.7 million ($6.8 million). Under US GAAP the net one-time charges were £63.2 million ($91.6 million).

Net loss (including exceptionals for UK GAAP and one-time charges for US GAAP): Net interest for the year increased from £9.6 million ($13.9 million) in 2000 to £10.9 million ($15.8 million) in 2001, as a result of investing cash balances for a full 12 month period compared to 8 months in 2000. Interest rates in 2001 were lower than in 2000. The net loss under UK GAAP for 2001 was £113.2 million ($164.1 million) and loss per share was £0.88 ($1.28). The net loss under US GAAP was £114.2 million ($165.6 million) and loss per share was £0.89 ($1.29).

Cash and cash equivalents: Cash and cash equivalents as of 31 December 2001 were £184.8 million ($268.0 million) compared with £265.1 million ($384.4 million) at 31 December 2000.

Funding

At 31 December 2001, our cash balances were £184.8 million. Liquid assets surplus to the immediate operating requirements of Group companies are managed centrally and invested to protect the safety of the principal in a variety of money market securities. Non-sterling revenues provided a natural hedge against non-sterling commitments for operating costs and expenditure during 2001.

Outlook

The Group continues to face a very challenging market and it remains difficult to predict the level of demand from our customers. However, with the addition of Marconi's optical components business and the supply agreement negotiated with Marconi, the Group believes it is better positioned to address the poor visibility and can offer a wide portfolio of products as the market improves.

The Group continues to actively monitor its costs and expects continued restructuring in the first quarter 2002 to control costs and realign the organisation following the acquisition of Marconi's optical component business. The Group anticipates that it will be able to achieve a cash burn rate of approximately £20.0 million ($29.0 million) per quarter, or below, on an ongoing basis except for the first quarter 2002, during which the acquisition is finalised.

The results of the optical components business acquired from Marconi will be included in the consolidated financial statements of Bookham Technology starting in the first quarter 2002.

DIRECTORS' REPORT

The directors present their report together with the audited financial statements for the year ended 31 December 2001.

A review of the Group's activities and its future development is contained on pages 1 to 8.

Results for the year

The Group made a loss of £113,238,000 (2000 £29,065,000) after taxation and the directors will not be recommending a dividend.

Research and development

The Group conducts research and development in fibre-optical components.

Annual General Meeting

Notice of the Annual General Meeting is enclosed together with a form of proxy.

Share capital

All changes in the share capital of the company are detailed in note 21.

Directors and their interests

The present directors are listed on pages 6 and 7 and their beneficial interests in the shares of the company are given on pages 15 and 16.

Charitable and political contributions

The Group donated £4,480 during the year. No political contributions were made during the year.

Subsequent events

Subsequent events are described on page 37.

Substantial shareholdings

As at 1 March 2002, the company had been notified that the following had a beneficial interest in 3% or more of the ordinary share capital of the company:

	Ordinary shares	
	Number	%
Andrew G Rickman*	27,673,809	19.35
Marconi plc**	12,891,000	9.01
CGNU plc***	5,666,663	3.96
3i Group plc	4,398,465	3.07

* Includes 9,945,600 ordinary shares of ⅓p each held by Nichola Rickman, the wife of Andrew Rickman, and 9,000,000 ordinary shares of ⅓p each held by the Rickman 1998 Accumulation and Maintenance Settlement Trust.

** Shares held by Marconi Optical Components Limited.

*** Includes (a) 2,592,183 ordinary shares held by BNY Norwich Union Nominees Ltd (b) 1,496,175 ordinary shares held by Vidacos Nominees Ltd (c) 869,564 ordinary shares held by CUIM Nominees Ltd and (d) 708,741 ordinary shares held by Chase GA Group Nominees Ltd.

Employees

The Group's policy is to consult and discuss with employees those matters likely to affect employees' interests. Meetings for this purpose are held at least quarterly. These meetings also seek to achieve a common awareness on the part of all employees of the financial and economic factors affecting the Group's performance. The employee share scheme encourages the involvement of employees in the Group's performance.

It is the policy of the Group that disabled people, whether registered or not, should receive full and fair consideration for all job vacancies for which they are suitable applicants. Employees who become disabled during their working life will be retained in employment wherever possible and will be given help with any necessary rehabilitation and retraining. The Group is prepared to modify procedures and equipment, wherever this is practicable, so that full use can be made of an individual's abilities. Training, career development and promotion are, as far as practicable, identical for all employees according to their skills and abilities.

Health, safety and welfare

The directors recognise the high standards required to ensure the health, safety and welfare of the Group's employees at work, its customers and the general public. Group policies and practices are regularly reviewed with the objective that high standards of health and safety are achieved and maintained.

Environment

The Group's environment policy is on page 42.

Creditor payment policy

The Group's current policy concerning the payment of creditors for goods and services is as follows:

- to pay in accordance with its contractual and legal obligations; and
- wherever it is reasonable to do so, to settle the terms of payments with those suppliers when agreeing terms for each transaction and to ensure that those suppliers are made aware of the terms of payments by their inclusion in the relevant contracts.

Creditor days for the company and Group at 31 December 2001 were 41 days (2000: 67 days) as calculated in accordance with the Companies Act 1985.

Auditors

During the year PricewaterhouseCoopers resigned as auditors and Ernst & Young LLP were appointed in their stead. A resolution to re-appoint Ernst & Young LLP as the Group's auditors and authorising the Directors to determine their remuneration will be put to the forthcoming Annual General Meeting.

Going concern

After making appropriate enquiries the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going-concern basis in preparing the accounts.

By order of the board

Philip Davis

Philip Davis Company Secretary
22 March 2002

CORPORATE GOVERNANCE

The directors recognise the importance of adopting good corporate governance practices in the best interests of the shareholders.

During the twelve months from January to December 2001, the Group complied in all respects with the provisions of the Code of Best Practice set out in Section 1 of Part 2 of the Combined Code except where otherwise indicated below. The ways in which we have complied with the Code are set out below.

The board has considered the independence of the non-executive directors and believes that all the non-executive directors are currently independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment. One director, Lori Holland, has a consulting agreement with us. This consulting agreement provides that Lori Holland shall render management consulting services for compensation consisting of cash and reimbursement of expenses. See "Related party transactions" on page 37.

The following narrative statement explains how the Group has applied the principles of good corporate governance contained in the Combined Code:

The board

For most of 2001, the board comprised two executive directors and six non-executive directors, following Giorgio Anania's appointment to the board in February 2001 as chief executive officer and an executive director. Directors' biographical details are set out briefly on pages 6 and 7. The board is headed by the chairman and is responsible to shareholders for leading and controlling the Group. It meets at least eight times a year, reviewing trading performance, ensuring adequate funding facilities are in place, setting and monitoring strategy, reviewing risk management processes, examining business expansion opportunities, and overseeing shareholder reporting.

The post of chairman is held by Andrew Rickman and he also held the post of chief executive officer until 14 February 2001, when Giorgio Anania was appointed to that position. In the board's opinion, the presence of six non-executive directors, with David Simpson as the senior independent non-executive, provides a proper balance of authority with the executive chairman and the chief executive officer, who are the only executive directors on the board.

When appointing new directors, the board receives recommendations from the Nomination Committee, which considers candidates' experience and knowledge of the technology sector together with their ability to contribute to a specific area of importance to the company. Due to the infrequent changes to the board there is no formal induction policy for new directors, with appropriate arrangements being made as required. All directors have access to the advice and services of the company secretary, and are permitted to take independent professional advice if necessary for the conduct of their duties, at the Group's expense.

To enable it to carry out its responsibilities, detailed information on the Group's operations is supplied to the board and reviewed at its meetings by the chief executive officer and the chief financial officer.

There is no limit on the number of years any of our directors may serve as a director. At every Annual General Meeting, any director who was elected or last re-elected at or before the Annual General Meeting held in the third calendar year before is subject to retirement by rotation. A director retiring by rotation may be re-elected at any general meeting. Our Articles of Association do not require directors to retire at a specific age.

At the forthcoming Annual General Meeting on Wednesday 12 June 2002, Dr Giorgio Anania and W. Arthur Porter will offer themselves for re-election and Joseph Cook will offer himself for election. Details of Dr. Anania's service contract, including the unexpired term, are contained on page 14. Dr. Porter's and Mr. Cook's letters of engagement can be terminated by the Company and by each of them on not less then 6 months notice, subject to the right of the Company to terminate earlier in usual circumstances.

The board has a Compensation Committee, a Nomination Committee, an Audit Committee and a Shares Committee.

Compensation Committee

The Compensation Committee is responsible for determining the contract terms, remuneration and other benefits of the executive directors and senior management, including their performance-related pay. The Remuneration Report, which includes details of directors' remuneration and beneficial interests in the company's share capital, together with information on their service contracts, is set out on pages 13 to 17.

The members of the Compensation Committee are:

W. Arthur Porter (Chairman)
David Simpson
Lori Holland

W. Arthur Porter took over from David Simpson as Chairman in April 2001. Lori Holland was appointed to the Compensation Committee following Graham Miller's retirement from the board on 31 December 2001.

Nomination Committee

The Nomination Committee is responsible for nominating candidates to fill board vacancies and making recommendations on board composition and balance.

The members of the Nomination Committee are:

Andrew Rickman (Chairman)
David Simpson
Lori Holland
W. Arthur Porter

Graham Miller took over from David Simpson as Chairman in April 2001. Following Graham Miller's retirement from the board on 31 December 2001, Andrew Rickman was appointed as Chairman of the Nomination Committee.

Audit Committee

The Audit Committee meets not less than four times annually and is responsible for, among other things, monitoring and planning, and reviewing the Group's annual and quarterly reports and accounts. It also involves the Group's auditors in that process, focusing particularly on compliance with legal requirements, accounting standards and the requirements of Nasdaq and the UK Financial Services Authority, and on an ongoing basis reviews the effectiveness of our systems of internal financial controls. It also advises the board on the appointment of the Group's auditors together with their remuneration for both audit and non-audit work. The ultimate responsibility for reviewing and approving our annual and quarterly reports and accounts remains with the board of directors.

By invitation, the Audit Committee's meetings are attended by the chief executive officer and the chief financial officer.

The members of the Audit Committee are:

Lori Holland (Chairman)
David Simpson
W. Arthur Porter

Shares Committee

The Shares Committee is an administrative committee responsible for authorising the exercise of share options in accordance with the rules of the Group's share option schemes and the authorisation of the exercise or transfer of warrants in accordance with the terms of the warrant agreements between the Group and the holders of its warrants. The responsibility for granting share options and warrants remains solely with the board. The members of the Shares Committee are Andrew Rickman, Giorgio Anania and the Company Secretary Philip Davis.

Communication with shareholders

As part of the Group's communication activities, detailed presentations are made to major institutional investors on a regular basis, including whenever a major event occurs. The board takes feedback received from these presentations and from other communications for shareholders into consideration wherever appropriate.

The Annual General Meeting is the occasion when the directors are routinely available to answer questions from shareholders, and the directors view this public accountability for their actions as being the main purpose of the meeting.

Accountability and Audit

The board believes that it has an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process is described more fully below and has been in place for the year under review and up to the date of approval of the annual accounts.

The Group does not currently have an internal audit function but as the Group continues to grow this is kept under review by the board.

The board has reviewed the effectiveness of its internal controls over operational and financial risks in the following manner:

- the board met at least every quarter during the year. At each such board meeting, executive briefings were presented to provide the board with detailed operational and financial information on the Group's activities and plans. Specific significant risks presented by the management team were discussed as deemed necessary; and
- the Group's auditors were engaged to review the Group's reported results and balance sheet at each quarter end, and to audit the annual results and balance sheet which are included in this report.

In December 2001, the Group carried out its annual assessment of the effectiveness of internal controls by conducting a formal review of its strategic business risks and the management actions in place for monitoring and minimising these risks. The results of this review have been reported to the board and a suitable risk management programme has been developed.

The board had overall responsibility for the Group's systems of internal control and for monitoring their effectiveness. Such systems can only provide reasonable and not absolute assurance against material misstatements or loss. The key elements of the Group's internal controls are outlined below.

Control environment—the existence of a clear organisational structure and well-defined lines of responsibility and delegation of appropriate authority. The integrity and competence of personnel are ensured through high recruitment standards, training and development programmes.

Risk management—business strategy and plans are reviewed by the board. Appraisals and evaluations of the financial implications are undertaken prior to commitments on major projects. During 2001, Lori Holland, as chairman of the Audit Committee, presented a Group risk analysis to the board each quarter.

Financial reporting—a comprehensive system of budgets and forecasts with monthly reporting of actual results against targets.

Control procedures—the Group currently has authorisation levels and procedures. Many of the processes are documented in the Group's quality manuals and are subject to audit by external compliance agencies on a regular basis. The systems of internal financial controls are formally being documented and updated to take into account the Group's growth. In addition, the Audit Committee meets with the Group's auditors to discuss the results of their audit work.

REMUNERATION REPORT

This report has been prepared in accordance with the provisions of Schedule B to the Combined Code.

The Compensation Committee is composed entirely of the non-executive directors identified on page 12 and is chaired by W. Arthur Porter. The Compensation Committee meets as required during the year and its terms of reference are to determine the Group's policy on executive remuneration and to consider and approve the individual terms and conditions of employment for the executive directors and senior management. The Compensation Committee takes advice where appropriate from the chief executive officer of the Group on matters other than his personal remuneration.

Remuneration policy

In forming the remuneration policy and the remuneration packages of the executive directors and senior management, the Compensation Committee balances the requirement to align the interest of the executive directors and senior management with those of the shareholders, with the creation of a culture of linking reward to the Group's performance and with the need to recruit and retain management of the highest calibre.

The executive directors' and senior management's remuneration consists of four components— basic salary, performance-related bonus, share options and pension provisions. The performance-related components comprising the quarterly bonus and certain share option grants are designed to incentivise the executive directors and senior management to perform at the highest level, and to align executive rewards with enhanced shareholder value in both the short and long term.

Basic salary is reviewed annually by the Compensation Committee after a review of the individual's performance and the overall performance of the business. Where appropriate, the Compensation Committee has regard to published remuneration information and to specific advice from independent remuneration consultants. Inflation is also taken into consideration.

The Compensation Committee determines a bonus for each executive director and senior manager based on criteria agreed with that person at the beginning of the financial year. These criteria include the achievement of budgeted profits and revenue growth. Bonuses are capped. The Compensation Committee also awards one-off bonuses for any major activities, such as acquisitions, not taken into consideration in the budget.

Pension provisions

Andrew Rickman received pension contributions equal to 20% of basic salary, which are paid into his personal defined contribution pension plan. Giorgio Anania received pension contributions equal to 9% of basic salary, which are paid into the Group's defined contribution pension scheme. Details of the schemes are given in note 24.

Service contracts

Andrew Rickman has a service contract with the company providing for his appointment as Chairman. Dr. Rickman's employment can be terminated at any time by the Company or Dr. Rickman on not less than 12 months' notice, subject to the Company having the right to terminate earlier in certain usual circumstances. The service contract does not provide for predetermined amounts of compensation in the event of early termination.

The company entered into a service contract with Giorgio Anania, on 23 July 2001 (effective from 14 February 2001) which provides for his appointment as chief executive officer and as a director. Dr. Anania's employment can be terminated at any time by the company or Dr. Anania on not less than 12 months notice, subject to the company having the right to terminate earlier in certain usual circumstances. The service contract does not provide for predetermined amounts of compensation in the event of early termination.

Non-executive remuneration

The board determines the remuneration of the non-executive directors. Non-executive directors do not participate in discussions about their own remuneration. Non-executive directors receive fees and also grants of share options annually. In determining the level of fees and share option grants to non-executive directors, the board has regard to specific advice from independent remuneration consultants. Annual option grants are made at or around the time of the Annual General Meeting.

Directors' emoluments

The following information provides details of the directors' emoluments for both the year under review and the corresponding prior period:

	2001	2000
	£000	£000
Executive directors:		
Andrew Rickman		
Salary	200	163
Bonus	30	20
Benefits in kind	21	16
Company pension contributions	23	35
	274	234
Giorgio Anania (for full year 2001)		
Salary	166	N/A
Bonus	43	N/A
Benefits in kind	17	N/A
Company pension contributions	11	N/A
	237	N/A
Non-executive directors (all fees):		
David Simpson	7	30
Robert Rickman	6	8
Jack Kilby	6	7
Graham Miller	6	7
Denis Pomroy (retired 8 August 2000)	—	1
W Arthur Porter	6	7
Lori Holland	6	7
	37	67

One director, Lori Holland, has a consulting agreement with the company. This consulting agreement provides that Lori Holland render management consulting services for compensation consisting of cash and reimbursement of expenses. See "Related party transactions" in note 29.

Graham Miller retired from the board on 31 December 2001.

Directors' interests

The directors' interests in the company's ordinary shares were as set out below.

	2001	2000
Andrew Rickman*	27,673,809	27,673,809
David Simpson	436,561	180,161
Graham Miller**	115,200	115,200
Robert Rickman†	1,148,878	1,104,478
Giorgio Anania	237,630	N/A

* Includes 9,945,600 ordinary shares held by Nichola Rickman, the wife of Andrew Rickman, and 9,000,000 ordinary shares held by the Rickman 1998 Accumulation and Maintenance Settlement Trust.

** Includes 115,200 ordinary shares held by Patricia Miller, the wife of Graham C C Miller.

† Includes 999,000 ordinary shares held by Marion Rickman, wife of Robert J Rickman.

The closing mid-market price of the company's shares on 31 December 2001 was £1.60 and the range of market prices during the year was between £0.79 and £14.89.

Directors' share options

The Compensation Committee determines the grant of share options to the executive directors. The board, acting on advice from independent renumeration consultants, determines the grant of share options to non-executive directors. The options granted during the year were at prevailing market rates and the conditions for their exercise are described in note 21.

Details of the share options held by the directors are as follows:

	Date of grant	31 December 2000	Granted during year	Exercised during year	31 December 2001	Exercise price per ordinary share £	Date from which exercisable	Expiry date
Giorgio Anania	07/9/98	280,000	—	—	280,000	1.083	7/03/00	7/09/08
	24/3/99	180,000	—	—	180,000	1.200	31/12/00*	24/3/09
	02/4/99	600,000	—	—	600,000	1.200	2/10/00	2/04/09
	13/3/00	180,000	—	—	180,000	10.00	31/12/01*	13/3/10
	03/8/01	—	1,000,000	—	1,000,000	1.710	03/02/03	3/08/11
David Simpson	10/7/95	222,000	—	222,000	—	0.003	1/2/99	10/7/05
	24/5/96	44,400	—	44,400	—	0.186	1/2/99	24/5/06
	15/4/98	333,600	—	—	333,600	0.847	15/10/01	15/4/08
	18/6/99	76,110	—	—	76,110	1.20	18/6/99	18/6/09
	30/4/01	—	64,378	—	64,378	3.23	30/4/01	30/4/11
Robert J Rickman	24/5/96	44,400	—	44,400	—	0.186	1/2/99	24/5/06
	18/6/99	76,110	—	—	76,110	1.20	18/6/99	18/6/09
	30/4/01	—	64,378	—	64,378	3.23	30/4/01	30/4/11
Graham CC Miller	27/10/95	222,000	—	—	222,000	0.186	27/4/99	27/10/05
	24/5/96	4,600	—	—	4,600	0.186	27/4/99	24/5/06
	18/6/99	76,110	—	—	76,110	1.20	18/6/99	18/6/09
	30/4/01	—	64,378	—	64,378	3.23	30/4/01	30/4/11
W Arthur Porter	15/4/98	243,235	—	—	243,235	0.847	15/10/01	15/4/08
	30/4/01	—	64,378	—	64,378	3.23	30/4/01	30/4/11
Lori Holland	20/1/99	256,338	—	—	256,338	1.083	20/1/99*	20/1/09
	18/6/99	76,110	—	—	76,110	1.20	18/6/99	18/6/09
	30/4/01	—	64,378	—	64,378	3.23	30/4/01	30/4/11
Jack Kilby	31/1/00	76,110	—	—	76,110	4.322	31/1/00	31/1/10
	30/4/01		40,236	—	40,236	3.23	30/4/01	30/4/11

No options were cancelled or lapsed during 2001.

On 8 February 2002, Dr Anania was granted a further 224,000 share options, with an exercise price of £1.22, exercisable from 8/8/03 and with an expiry date of 8/2/12.

* These options vest and become exercisable upon the completion of specified performance requirements.

Gains made by directors on share options

The table below shows gains made by individual directors from the exercise of share options and the market price of the company's shares at the dates of exercise:

	Year ended 31 December			
	2001		2000	
	Gain £000	Market price	Gain £000	Market price
Robert Rickman	139	£3.31	—	—
David Simpson	1,531	£6.90	—	—
David Simpson	139	£3.31	—	—
Graham Miller	—	—	1,326	£33.50
Denis Pomroy	—	—	2,458	£33.50
W Arthur Porter	—	—	756	£33.50
Lori Holland	—	—	1,026	£33.50
	1,809		5,566	

All share options granted to directors were granted under either the 1995 Scheme or the 1998 Scheme, details of which are included in note 21.

Directors' pension entitlements

Pension contributions to defined contribution pension schemes for the year ended 31 December 2001 were as follows:

	2001	2000
Andrew Rickman	23	35
Giorgio Anania	11	—

DIRECTORS' RESPONSIBILITIES

Statement of directors' responsibilities in respect of financial statements

The directors are required by UK company law to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and the Group as at the end of the financial year and of the profit or loss of the Group for that period.

The directors confirm that suitable accounting policies have been applied consistently, and reasonable and prudent judgments and estimates have been made in the preparation of the financial statements for the year ended 31 December 2001. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going-concern basis.

The directors are responsible for keeping proper accounting records and for taking reasonable steps to safeguard the assets of the company and the Group and to prevent and detect fraud and other irregular activities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF BOOKHAM TECHNOLOGY PLC

We have audited the Group's financial statements for the year ended 31 December 2001 which comprise the Consolidated Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement, Consolidated Statement of Total Recognised Gains and Losses, and the related notes 1 to 32. These financial statements have been prepared on the basis of the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

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

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the Group as at 31 December 2001 and of the loss of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
Reading
22 March 2002

CONSOLIDATED PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2001

	Note	Before Exceptional Items	Exceptional Items (Note 3)	2001	2000
				£000	£000
Turnover	1, 2	21,921	—	21,921	26,301
Cost of sales		(30,176)	(17,358)	(47,534)	(31,850)
Gross loss		(8,255)	(17,358)	(25,613)	(5,549)
Administrative expenses					
Research and development		(38,136)	(39,473)	(77,609)	(17,355)
National Insurance on share options		782	—	782	(1,070)
Selling, general and administrative expenses		(15,269)	(6,005)	(21,274)	(13,875)
Other		(527)	—	(527)	(847)
		(53,150)	(45,478)	(98,628)	(33,147)
Other operating income	6	76	—	76	61
Operating loss		(61,329)	(62,836)	(124,165)	(38,635)
Interest receivable	7	11,405	—	11,405	10,144
Interest payable	8	(478)	—	(478)	(574)
Loss on ordinary activities before taxation	3	(50,402)	(62,836)	(113,238)	(29,065)
Tax on loss on ordinary activities	9	—	—	—	—
Loss on ordinary activities after taxation		(50,402)	(62,836)	(113,238)	(29,065)
Loss per ordinary share (basic and diluted) (£)	10	(0.39)	(0.49)	(0.88)	(0.25)

All income is generated from continuing activities. There is no difference between the loss on ordinary activities after taxation stated above and its historic cost equivalent.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Note	2001	2000
		£000	£000
Loss for the financial year	22	(113,238)	(29,889)
Exchange difference on translation of subsidiaries	22	1	(1)
Total losses recognised in the year		(113,237)	(29,890)

The notes on pages 23 to 42 form an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET

as at 31 December 2001

	Note	2001 £000	2000 £000
Fixed assets			
Intangible assets	11	1,666	447
Tangible assets	12	34,579	44,264
		36,245	44,711
Current assets			
Stocks	14	2,564	6,961
Debtors	15	5,001	13,239
Short-term investments	27	—	1,525
Cash at bank and in hand	16	184,814	265,083
		192,379	286,808
Creditors: amounts falling due within one year	17	(17,675)	(25,572)
Net current assets		174,704	261,236
Total assets less current liabilities		210,949	305,947
Creditors: amounts falling due after more than one year	18	—	(897)
Provisions for liabilities and charges	19	(79)	(988)
Net assets		210,870	304,062
Capital and reserves			
Called-up share capital	21, 22	434	424
Share premium account	22	338,576	321,388
Other reserve	22	5,716	2,829
Profit and loss account	22	(133,856)	(20,579)
Equity shareholders' funds	22	210,870	304,062

Approved by the board of directors on 22 March 2002 and signed on its behalf by:

Andrew Rickman Director

The notes on pages 23 to 42 form an integral part of these financial statements.

COMPANY BALANCE SHEET

as at 31 December 2001

	Note	2001	2000
		£000	£000
Fixed assets			
Intangible assets	11	1,666	447
Tangible assets	12	34,579	44,071
Investments	13	62	62
		36,307	44,580
Current assets			
Stocks	14	2,524	6,961
Debtors	15	4,784	13,665
Short-term investments		—	1,525
Cash at bank and in hand	16	184,722	264,847
		192,030	286,998
Creditors: amounts falling due within one year	17	(17,405)	(25,641)
Net current assets		174,625	261,357
Total assets less current liabilities		210,932	305,937
Creditors: amounts falling due after more than one year	18	—	(897)
Provisions for liabilities and charges	19	(79)	(988)
Net assets		210,853	304,052
Capital and reserves			
Called-up share capital		434	424
Share premium account		338,576	321,388
Other reserve		5,716	2,829
Profit and loss account		(133,873)	(20,589)
Equity shareholders' funds		210,853	304,052

Approved by the board of directors on 22 March 2002 and signed on its behalf by:

Andrew Rickman

Andrew Rickman Director

The notes on pages 23 to 42 form an integral part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2001

	Note	2001 £000	2000 £000
Net cash outflow from operating activities	26	(44,385)	(38,167)
Returns on investments and servicing of finance:			
Interest received		11,405	10,144
Interest paid		(4)	—
Interest element of finance lease rentals		(301)	(374)
		11,100	9,770
Capital expenditure and financial investment			
Purchase of intangible fixed assets		(1,812)	(486)
Purchase of tangible fixed assets		(39,896)	(28,280)
Proceeds on disposal of fixed assets		96	31
		(41,612)	(28,735)
Acquisitions and disposals			
Purchase of subsidiary undertakings		(6,796)	—
Net cash outflow before management of liquid resources and financing		(81,693)	(57,132)
Management of liquid resources			
Reduction in short-term investments	27	1,525	5,690
Financing			
Issue of ordinary share capital	22	1,256	338,238
Expenses of share issues	22	—	(24,270)
Capital element of finance lease rental payments	27	(1,357)	(1,377)
		(101)	312,591
(Decrease)/increase in cash	27	(80,269)	261,149
Reconciliation of net cash flow to movement in net funds			
(Decrease)/increase in cash in the year	27	(80,269)	261,149
Cash outflow from finance lease repayments	27	1,357	1,377
Cash inflow from decrease in liquid resources	27	(1,525)	(5,690)
(Decrease)/increase in net funds resulting from cash flows	27	(80,437)	256,836
Translation difference	27	—	(1)
(Decrease)/increase in net funds in the year		(80,437)	256,835
Net funds at beginning of the year	27	264,354	7,519
Net funds at end of the year	27	183,917	264,354

The notes on pages 23 to 42 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2001

1 Accounting policies

The financial information contained in this report has been prepared in accordance with applicable accounting standards in the United Kingdom.

A summary of the principal accounting policies, which have been applied for all periods covered by this report, is set out below.

(1) Basis of accounting

The financial information in this report has been prepared under the historical cost convention and on a going-concern basis.

(2) Group consolidation

The Group accounts consolidate the accounts of Bookham Technology plc and all its subsidiary undertakings drawn up to 31 December each year. No profit and loss account is presented for Bookham Technology plc as permitted by section 230 of the Companies Act 1985. Measurement Microsystems A-Z Inc. has been included in the Group accounts using the acquisition method of accounting. Accordingly the Group profit and loss account and statement of cash flows include the results and cash flows of Measurement Microsystems A-Z Inc. for the 11 month period from its acquisition on 25 January 2001. The purchase consideration has been allocated to assets and liabilities on the basis of fair value at the date of acquisition. Intra-Group sales and profits are eliminated fully on consolidation.

(3) Turnover

Turnover represents the amounts (excluding value-added tax) derived from the provision of goods and services to third-party customers during the period.

Turnover is recognised upon shipment, with the exception of certain of the Group's products which are shipped to a third party for resale to end users. The Group defers recognition of such shipments as turnover until the product is sold by the third party.

The Group uses the percentage-of-completion method, based on costs incurred and milestones accepted by the customer for recognising revenues on fixed-fee, non-recurring engineering contracts.

(4) Research and development expenditure

Research and development expenditure is charged to the profit and loss account in the period in which the expenditure is incurred.

(5) Goodwill

Goodwill is calculated as the surplus of cost over fair value attributed to the net assets (excluding goodwill) of subsidiaries. Goodwill is amortised on a straight line basis over its estimated useful life. Goodwill is reviewed for impairment in accordance with FRS 10 and impairment loss is included in accumulative amortisation.

(6) Intangible fixed assets and amortisation

Intangible fixed assets are stated at cost less amortisation. Amortisation is provided by the Group to write off the cost of intangible fixed assets on a straight-line basis over their estimated useful economic lives. Intangible fixed assets consist of patent licence fees payable to third parties and patents acquired from third parties.

(7) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less depreciation. Depreciation is provided by the Group to write off the cost of tangible fixed assets on a straight-line basis over their estimated useful economic lives as follows:

Plant and machinery	Three to five years
Fixtures, fittings and equipment	Three to five years
Computer equipment	Three years

No depreciation is provided for land or for assets in the course of construction.

(8) Investments

Investments in subsidiary undertakings are shown at cost less provision for any impairment in value.

(9) Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes all direct costs of manufacture and a proportion of manufacturing overheads.

(10) Government grants

Government grants received in respect of research and development expenditure are credited to the profit and loss account in the period to which the relevant expenditure relates.

(11) Leases

Assets held under finance leases are capitalised and depreciated over their estimated useful lives or the term of the lease, whichever is shorter. Future instalments under such leases, net of financial charges, are included in creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element, which reduces the outstanding obligations.

Costs in respect of operating leases are charged on a straight-line basis over the lease term.

(12) Foreign currency translation

In individual companies, balances denominated in foreign currencies are translated into reporting currencies at the rates ruling at the year end. Transactions in foreign currencies are translated into reporting currencies using average rates of exchange. Exchange differences are dealt with in the profit and loss account.

On consolidation, the balance sheets of the Group's overseas subsidiary undertakings are translated into sterling at rates of exchange ruling at the year end. The profit and loss accounts of the Group's overseas subsidiary undertakings are translated into sterling using average rates of exchange. Translation differences are taken to reserves.

(13) Deferred taxation

The charge for taxation is based on the result for the year. A deferred tax asset or provision is established to the extent that it is likely that such an asset or liability will crystallise in the foreseeable future.

(14) Pension costs

The Group pays contributions into the Group defined contribution pension scheme for the executive directors and employees. In addition, the company has a defined contribution plan for the benefit of one director. The charge to the profit and loss account reflects those contributions payable in the period. The Group has no other liability in respect of these pension contributions.

(15) Share options issued to employees

The Group recognises as a charge to the profit and loss account ("stock compensation expense") the amount by which the fair value of any share options issued to employees exceeds their respective exercise prices at the date of grant. The fair value is assessed by reference to the market value of the Company's shares. These costs are recognised over the vesting period. Amounts charged to the profit and loss account are included in other reserves.

(16) Warrants and share options issued to non-employees

Where share options or warrants are granted to non-employees in respect of services rendered, the fair value of the consideration received is recognised as a cost over the period to which the services relate. With the exception of costs related to fundraising, which are included in issue costs and charged to the share premium account, costs are charged to the profit and loss account.

2 Segmental analysis

In the opinion of the directors, the Group has one class of business, the design, development, manufacture and marketing of fibre-optic components. Its activities are principally carried out in the United Kingdom. The table below analyses turnover by destination:

	2001	2000
	£000	£000
United Kingdom	13,306	20,474
USA	2,002	4,523
Japan	3,862	24
Rest of World	2,751	1,280
	21,921	26,301

3 Loss on ordinary activities before taxation

	2001	2000
	£000	£000
Loss on ordinary activities before taxation is stated after charging:		
Auditors' remuneration:		
Audit PwC	14	117
Other services PwC	49	88
Audit (E&Y)	125	—
Other Services (E&Y)	42	—
Amortisation:		
Goodwill	1,679	—
Patents, licenses and other	1,147	341
Depreciation:		
Owned assets	7,137	3,374
Assets held under finance leases	1,224	1,194
Loss/(gain) on disposal of fixed assets	(8)	20
Loss/(gain) on foreign exchange	194	316
Amounts payable under operating leases:		
Hire of plant and machinery	166	143
Land and buildings	1,153	594
Exceptional items:		
Impairment of intangible assets	22,396	—
Impairment of tangible fixed assets	32,597	—
Stock write-downs and order cancellation costs	4,653	—
Voluntary severance costs	3,190	—
	62,836	—

4 Staff costs

The average number of persons employed by the Group (including executive directors) during the period, analysed by category, was as follows:

	2001	2000
Administration	78	65
Sales	48	33
Research and development	266	169
Manufacturing	387	348
	779	615

	2001	2000
	£000	£000
The aggregate payroll costs of these persons were as follows:		
Wages and salaries	26,306	13,856
Stock compensation expense	329	531
Social security costs	2,544	1,592
Other pension costs	999	88
	30,178	16,067

Payroll costs exclude the unpaid portion of the provision for National Insurance liabilities on share options referred to in note 19.

5 Directors

Directors' remuneration

	2001	2000
	£000	£000
Aggregate emoluments	514	301
Aggregate gains made on the exercise of share options	1,809	5,566
Company contributions to defined contribution pension schemes	34	35
	2,357	5,902

Retirement benefits under defined contribution pension schemes were accruing to two directors at 31 December 2001, and to one director at 31 December 2000.

Further details of directors' remuneration are set out in the Remuneration Report on pages 13 to 17.

6 Other operating income

	2001	2000
	£000	£000
Grant income	—	43
Sale of scrap and other income	76	18
	76	61

7 Other interest receivable and similar income

	2001	2000
	£000	£000
Bank interest	11,405	10,144

8 Interest payable and similar charges

	2001	2000
	£000	£000
Finance charges payable in respect of finance leases hire purchase contracts	478	574

Finance charges payable includes £173,000 (2000: £200,000) of amortisation in respect of warrants issued to a leasing company in 1999, as described in note 21.

9 Taxation

No corporation tax charge has arisen in either of the years ended 31 December 2001 and 2000. No benefit has been recognised for the substantial tax losses incurred and carried forward each year. At 31 December 2001, the Group had £82,371,000 of losses available for carry forward (2000: £59,145,000).

10 Loss per ordinary share

Loss per ordinary share has been calculated by dividing the loss for the financial year by the weighted average number of ordinary shares in issue during the year, as set out below:

	2001	2000
Loss for the financial year (£000)	(113,238)	(29,065)
Weighted average number of shares	128,533,108	116,231,841
Loss per ordinary share (basic and diluted) (£)	(0.88)	(0.25)

The loss per ordinary share has been adjusted to reflect the six-for-one share split referred to in note 21.

The Group had share options and warrants which are potential ordinary shares outstanding during the period. Conversion of these potential ordinary shares into ordinary shares would decrease the net loss per ordinary share and would not therefore be dilutive.

11 Intangible fixed assets

	Company		Group		
	Patent & Licences	Total	Goodwill	Patent & Licences	Total
	£000	£000	£000	£000	£000
Cost					
At 1 January 2001	486	486	—	486	486
Additions during the period	1,560	1,560	—	1,560	1,560
Acquistions (note 20)	—	—	18,224	6,657	24,881
At 31 December 2001	2,046	2,046	18,224	8,703	26,927
Amortisation					
At 1 January 2001	39	39	—	39	39
Charge during the period	341	341	1,679	1,147	2,826
Impairment during the period	—	—	16,545	5,851	22,396
At 31 December 2001	380	380	18,224	7,037	25,261
Net book value at 31 December 2001	1,666	1,666	—	1,666	1,666
Net book value at 31 December 2000	447	447	—	447	447

Impairment of the goodwill and patents arising on the acquisition of Measurement Microsystems A-Z Inc ("MM") occurred in the year due to a decline in market growth and obsolescence of intellectual property. Goodwill and patents arising on the acquisition of MM was being amortised over seven years. Other patents and licenses are being amortised over periods of three to five years.

12 Tangible fixed assets

Group	Freehold land	Plant and machinery	Fixtures, fittings and equipment	Computer equipment	Total
	£000	£000	£000	£000	£000
Cost					
At 1 January 2001	12,324	33,129	3,820	3,962	53,235
Additions during the period	—	26,443	2,155	2,762	31,360
Disposals during the period	—	(52)	(132)	(62)	(246)
At 31 December 2001	12,324	59,520	5,843	6,662	84,349
Accumulated depreciation					
At 1 January 2001	—	7,550	384	1,037	8,971
Charge for the period	—	6,790	722	849	8,361
Disposals during the period	—	(48)	(67)	(44)	(159)
Impairment during the period	3,686	24,340	1,725	2,846	32,597
At 31 December 2001	3,686	38,632	2,762	4,688	49,770
Net book value at 31 December 2001	8,638	20,888	3,079	1,974	34,579
Net book value at 31 December 2000	12,324	25,579	3,436	2,925	44,264

Company	Freehold land	Plant and machinery	Fixtures, fittings and equipment	Computer equipment	Total
	£000	£000	£000	£000	£000
Cost					
At 1 January 2001	12,324	32,937	3,820	3,941	53,022
Additions during the period	—	26,443	2,155	2,457	31,055
Disposals during the period	—	(36)	(132)	(51)	(219)
At 31 December 2001	12,324	59,344	5,843	6,347	83,858
Accumulated depreciation					
At 1 January 2001	—	7,540	384	1,027	8,951
Charge for the period	—	6,790	720	800	8,310
Disposals during the period	—	(36)	(67)	(38)	(141)
Impairment during the period	3,686	24,162	1,725	2,586	32,159
At 31 December 2001	3,686	38,456	2,762	4,375	49,279
Net book value at 31 December 2001	8,638	20,888	3,081	1,972	34,579
Net book value at 31 December 2000	12,324	25,397	3,436	2,914	44,071

The net book value of assets held under finance leases was £1,031,000 at 31 December 2001 (2000 £2,255,000). Assets held under finance leases are included in plant and machinery above. The outstanding obligations under the leases are secured on the related assets.

Fixed assets include assets in the course of construction which have not been depreciated, amounting to £7,569,000 at 31 December 2001 (2000 £5,376,000). These assets consist of £5,854,000 in plant and machinery, £582,000 in fixtures and fittings and £1,134,000 in computer equipment.

13 Investments in Group undertakings

The company holds a 100% interest in the ordinary shares of the following subsidiary undertakings:

Name of undertaking	Activity	Country of incorporation	Date of acquisition
Bookham Technology Inc	Manufacturing & Distribution	USA	28 February 1997
Bookham Technology KK	Distribution	Japan	10 September 1999
Measurement Microsystems A-Z Inc	Research & Development	Canada	25 January 2001
Bookham Acquisition Inc	Intermediate holding company	Canada	25 January 2001
Bookham Exchange Inc	Intermediate holding company	Canada	25 January 2001

All interests are held directly, with the exception of the holding in Bookham Exchange Inc.

Subsidiary undertakings operate principally in their country of incorporation and all of the above companies have been included in the Group consolidation.

Company	Cost at 1 Jan 2001	Additions	Impairment	Cost at 31 Dec 2001
	£000s	£000s	£000s	£000s
Bookham Technology Inc	57	—	—	57
Bookham Technology KK	5	—	—	5
Measurement Microsystems A-Z Inc	—	24,673	(24,673)	—
Bookham Acquisition Inc	—	—	—	—
Bookham Exchange Inc	—	—	—	—
Total	62	24,673	(24,673)	62

14 Stocks

	Company		Group	
	2001	2000	2001	2000
	£000	£000	£000	£000
Raw materials	1,589	4,197	1,629	4,197
Work in progress	15	2,007	15	2,007
Finished goods	920	757	920	757
	2,524	6,961	2,564	6,961

15 Debtors

	Company		Group	
	2001	2000	2001	2000
	£000	£000	£000	£000
Trade debtors	822	9,009	822	9,009
UK VAT receivable	1,599	2,864	1,599	2,864
Other debtors	152	218	192	246
Amounts due from Group undertakings	—	454	—	—
Prepayments and accrued income	2,211	1,120	2,388	1,120
	4,784	13,665	5,001	13,239

Amounts due from Group undertakings are unsecured, interest-free and have no fixed date of repayment.

16 Cash at bank and in hand

	Company		Group	
	2001	2000	2001	2000
	£000	£000	£000	£000
Cash at bank	184,722	264,847	184,814	265,083

17 Creditors: amounts falling due within one year

	Company		Group	
	2001	2000	2001	2000
	£000	£000	£000	£000
Finance leases (note 25(3))	897	1,357	897	1,357
Trade creditors	7,820	19,200	9,324	19,217
Other creditors	911	859	911	773
Amounts due to Group undertakings	2,629	—	—	—
Taxation and social security	565	1,712	565	1,712
Accruals and deferred income	4,583	2,513	5,978	2,513
	17,405	25,641	17,675	25,572

18 Creditors: amounts falling due after more than one year

	Company and Group	
	2001	2000
	£000	£000
Finance leases (note 25(3))	—	897

19 Provisions for liabilities and charges

National Insurance on share options

	Company and Group	
	2001	2000
	£000	£000
At 1 January	988	89
(Credit) charge to profit and loss account	(782)	1,070
Payments	(127)	(171)
At 31 December	79	988

Provision has been made at 31 December 2001 for UK National Insurance (NIC) liabilities that are expected to become payable upon the exercise of certain share options granted under unapproved schemes between 6 April 1999 and 14 November 2000. The provision comprises the difference between the exercise price and the estimated fair market value of the shares at the balance sheet date at the current NIC rate, and apportioned on a straight-line basis over the vesting period of the options. In accordance with UK legislation introduced in 2001, certain options which had an exercise price in excess of the market price at 7 November 2000 will not give rise to any future liability for NIC. Details of the vesting of share options are given in note 21.

Deferred tax

	Company and Group	
	2001	2000
	£000	£000
Difference between accumulated depreciation and capital allowances	(12,447)	(481)
Trading losses	(32,371)	(11,856)
Deferred tax asset	(44,818)	(12,337)

The deferred tax assets arising as at each year end, which have been calculated at 30% in 2001 and 20% in 2000, the small companies' rate, have not been recognised.

20 Acquisitions and disposals

On 25 February 2001 the Company acquired the entire share capital of Measurement Microsystems A-Z Inc for a consideration of £6,796,000 ($10 million) and 2,108,957 ordinary shares, including 702,986 ordinary shares contingent upon certain performance milestones being achieved. In the year the performance milestones for 421,792 of these shares were met and the performance milestone relating to the remaining 281,194 shares will not be met following the Group's decision to discontinue development efforts and close the operation.

Net assets at the date of acquisition:

	Book Value	Revaluation	Fair value to Group
	£000	£000	£000
Intangible fixed assets	45	6,612	6,657
Tangible fixed assets	42	—	42
Debtors	108	—	108
Stock	10	—	10
Creditors falling due within one year	(340)	45	(295)
Creditors falling due after more than one year	(73)	—	(73)
Net assets	(208)	6,657	6,449
Goodwill arising on acquisition			18,224
			24,673
Analysis of consideration			
Cash			6,796
Bookham Ordinary Shares			17,877
			24,673

The revaluation of intangible fixed assets represents the fair value of separately identifiable patents valued by a suitably qualified independent valuer.

In the period from 25 February 2001 to 31 December 2001 Measurement Microsystems A-Z Inc made no sales outside of the Group and all of its costs were reimbursed by Bookham Technology plc. Measurement Microsystems A-Z Inc incurred a loss of £411,000 in the year ended 30 September 2000 and a loss of £194,000 from 1 October 2000 to 24 February 2001.

21 Share capital

Called-up share capital

	2001	2000
	£000	£000
Authorised		
200,100,000 ordinary shares of ⅓p each (2000 160,500,000)	667	535
Allotted, issued and fully paid		
130,160,413 ordinary shares of ⅓p each (2000 127,317,473)	434	424

2001

On 26 April 2001, the company's shareholders approved an increase in the authorised share capital of the company by approving the creation of an additional 39,600,000 ordinary shares.

During 2001, the company also issued 1,558,136 of ordinary shares under the 1995 and 1998 Employee Share Option Schemes.

On 25 January 2001, the company agreed to issue at a future date up to 2,108,957 ordinary shares to the shareholders of Measurement Microsystems Inc. ("MM") as consideration for the acquisition of the entire share capital of MM. Issue of 702,986 shares was contingent upon the achievement of performance milestones by MM employees. At 31 December 2001, 1,282,304 ordinary shares had been issued under the agreement and 545,459 remain to be issued. The remaining 281,194 ordinary shares relate to a performance milestone that will now not be met.

Employee share option schemes

At 31 December 2001, the Group had four employee share option schemes, details of which are set out below.

1995 Employee Share Option Scheme

Pursuant to the 1995 Employee Share Option Scheme (the "1995 Scheme") options to purchase ordinary shares were granted to employees during the period from 10 July 1995 to 29 September 1998. At 31 December 2001 there were no options authorised for future issuance under this scheme and there were options over 1,267,276 shares outstanding. The options expire ten years after the date of grant and are exercisable to the extent vested. Vesting generally occurs at the rate of one-third each at 18 months, 30 months and 42 months after the date of grant. All share options were granted for nil consideration. The scheme is unapproved by the UK Inland Revenue.

1998 Employee Share Option Scheme

At 31 December 2001, the total options authorised for future issuance under the 1998 Employee Share Option Scheme (the "1998 Share") when combined with the 2001 Approved Sharesave Scheme and the 2001 Approved Employee Share Option Scheme was 19,200,000 and there were options over 11,755,224 options outstanding. The options expire ten years after the date of grant and are exercisable to the extent vested. Except as set out below, vesting generally occurs at the rate of one-third each at 18 months, 30 months and 42 months after the date of grant.

Included in the above are a total of 1,393,214 performance related options that were outstanding at 31 December 2001 under the 1998 Scheme. These options vest one-quarter every six months based on the achievement of specific targets. Where targets are exceeded by a defined percentage, there is a potential for one-half of the options to vest at the end of each six-month period.

If these targets are not met, these options will vest in full in four to seven years after the date of grant as specified in the individual option certificate. The total number of shares subject to options granted does not vary as a result of the potential earlier vesting.

The exercise prices and number of shares shown below relate to the shares after the six-for-one share split on 13 March 2000.

All share options granted under the 1998 Scheme have been granted for nil consideration. The scheme is unapproved by the UK Inland Revenue.

Details of directors' share options are given in the Remuneration Report on pages 13 to 17.

2001 Approved Employee Share Option Scheme (formerly known as the 2000 Approved Employee Share Option Scheme)

The 2001 Approved Employee Share Option Scheme was approved by shareholders in February 2000. All executive directors and employees are eligible to participate. Options are granted at no cost at the discretion of the board, and vesting may include performance conditions. The option price is the market value of the Group's shares on the date of the grant, and options vest between three and ten years from date of grant. At 31 December 2001, the total options authorised for future issuance under this scheme, when combined with the 1998 Scheme and the 2001 Approved Sharesave Scheme, was 19,200,000 and there were no share options outstanding under the scheme. The scheme has been approved by the Inland Revenue.

2001 Approved Sharesave Scheme (formerly known as the 2000 Approved Sharesave Scheme)

The Approved Sharesave Scheme was approved by shareholders in February 2000. All full time directors and all employees with five years service or such shorter period as the board determines and those that the board deems appropriate, are eligible to participate in the scheme. Options to be issued under the scheme are dependent on the savings made by the employee and the option price determined by the board, which shall be not less than 85% of the mid-market price on the date preceding the date which employees are invited to apply for options. Options will normally be exercisable for three to five years from the commencement of the savings contract established by the employee. At 31 December 2001, the total options authorised for future issuance under this scheme, when combined with the 1998 Scheme and the 2001 Approved Employee Share Option Scheme, was

19,200,000 and there were 1,047,826 options outstanding under the scheme. The scheme has been approved by the Inland Revenue.

Stock compensation expense

The Group has granted share options to certain employees at exercise prices below the fair market value of the underlying ordinary shares at the date of grant. The differences have been charged to the profit and loss account over the vesting period of the options. The stock compensation expense was £329,000 in the year ended 31 December 2001 (2000 £531,000).

Ordinary share warrants and options issued to non-employees

During 1997 and 1998, the Group issued warrants to purchase 99,466 and 21,000 ordinary shares respectively to non-employees in connection with the issuance of share capital. These warrants were immediately exercisable at prices between £6.50 and £9.20 per share and expired on 3 October 2000. 1,000 warrants were subsequently cancelled. All the remaining warrants were exercised during 2000.

During 1999, the Group issued a warrant to purchase 137,988 ordinary shares to a leasing company. The warrant was immediately exercisable at £7.20 and expires on 11 April 2004. During 2001, warrants in respect of 417 shares were exercised and warrants in respect of 21,877 shares were exercisable as of 31 December 2001.

During 1999, the Group granted share options to three consultants to purchase 57,600 ordinary shares under the 1998 Scheme. These options vested upon the completion of specified performance requirements, all of which were met in the year ended 31 December 2000. Options over 48,000 shares are exercisable at £6.50 and options over 9,600 shares are exercisable at £7.20. During 2000, options over 5,277 shares were exercised at £6.50 and options over 2,602 shares were exercised at £7.20. During 2001 no options were exercised. The remaining options expire ten years from the date of grant.

The profit and loss account includes a charge of £173,000 (2000 £1,603,000) in respect of warrants and options granted to non-employees.

No shares have been authorised for future issuance of warrants. The number of shares reported in this note does not reflect the six-for-one share split approved on 13 March 2000.

A summary of share options movements is given below:

	Range of exercise prices	Options outstanding	Weighted average exercise price £
Outstanding as at 31 December 1999	£0.003–£3.10	11,180,394	1.03
Granted	£4.322–£36.05	3,354,210	12.56
Exercised	£0.003–£1.36	(2,413,145)	0.68
Cancelled	£0.75–£36.05	(93,074)	3.17
Outstanding as at 31 December 2000	£0.003–£36.50	12,028,385	4.28
Granted	£1.120–£7.03	6,559,192	2.09
Exercised	£0.003–£1.083	(1,556,338)	0.35
Cancelled	£1.20–£36.50	(2,960,913)	7.51
Outstanding as at 31 December 2001	£1.083–£36.50	14,070,326	3.31

22 Reconciliation of movements in shareholders' funds

Group	Share capital	Share premium account	Other reserve	Profit and loss account	Total shareholders' funds
	£000	£000	£000	£000	£000
At 31 December 2000	424	321,388	2,829	(20,579)	304,062
Loss for the year	—	—	—	(113,238)	(113,238)
Shares issued/to be issued	10	16,764	2,385	—	19,159
Refund of share issue costs	—	424	—	—	424
Translation adjustment	—	—	—	(39)	(39)
Stock compensation expense	—	—	329	—	329
Warrant/non-employee option expense	—	—	173	—	173
At 31 December 2001	434	338,576	5,716	(133,856)	(210,870)

Company	Share capital	Share premium account	Other reserve	Profit and loss account	Total shareholders' funds
	£000	£000	£000	£000	£000
At 31 December 2000	424	321,388	2,829	(20,589)	304,052
Loss for the year	—	—	—	(113,244)	(113,244)
Shares issued/to be issued	10	16,764	2,385	—	19,159
Refund of share issue costs	—	424	—	—	424
Translation adjustment				(40)	(40)
Stock compensation expense	—	—	329	—	329
Warrant/non-employee option expense	—	—	173	—	173
At 31 December 2001	434	338,576	5,716	(133,873)	210,853

Other reserves comprise of shares issued to warrant holders and non-employees in consideration for services performed (£2,147,000), shares issued to employees at values below the fair market value at date of issue (£1,184,000), and shares reserved for issue in connection with the acquisition of Measurement Microsystems A-Z Inc. (£2,385,000).

23 Company profit and loss account

In accordance with the exemption allowed by Section 230 of the Companies Act 1985 no profit and loss account has been presented by the company. The loss for the financial year dealt with in the accounts of the company is £113,244,000 (2000: £29,071,000).

24 Pensions

The Group pays contributions into the Group's defined contribution pension scheme for directors and employees.

The Group also has a defined contribution plan for the benefit of one director.

The Group's contributions to the plans are charged to the profit and loss account in the year to which they relate. The Group does not accept any responsibility for the benefit gained from these schemes. Accordingly the Group has no other liability in respect of these pension arrangements. There were no amounts outstanding in respect of payments due to pension plans at 31 December 2001 (2000: £nil).

25 Commitments

(1) Capital commitments

The Group had capital commitments of £2,795,000 at 31 December 2001 (2000: £14,447,000).

(2) Operating leases

Annual commitments under non-cancellable operating leases are as follows:

	Company		Group	
	2001	2000	2001	2000
	£000	£000	£000	£000
Land and buildings				
Operating leases which expire:				
Within one year	334	12	679	46
In the second to fifth year inclusive	—	304	49	304
After the fifth year	568	889	1,803	889
	902	1,205	2,531	1,239
Other				
Operating leases which expire:				
Within one year	13	—	13	—
In the second to fifth year inclusive	112	94	112	94
	125	94	125	94

(3) Finance lease commitments

Commitments for future minimum payments under finance leases are as follows:

	Company and Group	
	2001	2000
	£000	£000
Within one year	897	1,357
In the second to fifth year inclusive	—	897
Obligations under finance leases (note 17,18)	897	2,254

26 Reconciliation of operating loss to net cash flow from operating activities

	2001	2000
	£000	£000
Operating loss	(124,165)	(38,635)
Depreciation, amortisation and impairment charge	66,180	4,607
Stock compensation expense	329	531
Warrant/non-employee option expense	—	1,403
(Profit)/loss on sale of fixed assets	(8)	20
Decrease/(increase) in stocks	4,397	(6,204)
Decrease/(increase) in debtors	8,238	(10,511)
Increase in creditors	1,563	9,723
(Decrease)/increase in provisions for liabilities and charges	(909)	899
Net cash outflow from operating activities	(44,375)	(38,167)

27 Analysis of net funds

	Cash at bank and in hand	Restricted cash	Short-term investments	Finance leases	Total
	£000	£000	£000	£000	£000
At 1 January 2000	1,685	2,250	7,215	(3,631)	7,519
Cash flow	262,949	(1,800)	(5,690)	1,377	256,836
Translation difference	(1)	—	—	—	(1)
At 31 December 2000	264,633	450	1,525	2,254	264,354
Cash flow	(79,819)	(450)	(1,525)	(1,357)	(80,437)
At 31 December 2001	184,814	—	—	(897)	183,917

Short-term investments comprise treasury cash deposits with a maturity of between one and ninety days at inception.

28 Financial instruments

The Group's financial instruments comprise finance leases, cash and liquid resources and various items, such as debtors and creditors, that arise directly from its operations. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken. The main risks arising from the Group's financial instruments are interest rate risk and foreign currency risk. The Group's risk management policy is disclosed on page 8.

Interest rate risk

The Group finances its operations through a mixture of shareholders' funds, finance leases and working capital. Throughout the period, the Group had no borrowings other than finance leases, and its only exposure to interest rate fluctuations was on its cash deposits.

The Group monitors its interest rate risk on cash balances primarily through cash flow forecasting. Cash which is surplus to immediate requirements is invested in short-term deposits with banks with maturity dates of up to three months and invested in overnight money market accounts.

Foreign currency risk

The Group's principal exposure to currency risk arises from sales and purchases made in US dollars by the Group. Currency risk has historically been monitored by maintaining a US dollar bank account for settlement of its US dollar liabilities. No forward currency contracts have been entered into by the Group.

Short-term debtors and creditors

Short-term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures.

Interest rate risk profile of financial assets and liabilities

Financial assets

The interest and currency profiles of the Group's financial assets were:

	Total	Floating rate financial assets	Fixed rate financial assets
	£000	£000	£000
At 31 December 2001			
Sterling	180,465	180,465	—
US dollars	3,471	3,471	—
Euro	824	824	—
Canadian Dollars	51	51	—
Japanese yen	3	3	—
	184,814	184,814	—
At 31 December 2000			
Sterling	264,856	263,331	1,525
US dollars	1,651	1,651	—
Euro	96	96	—
Japanese yen	5	5	—
	266,608	265,083	1,525

Interest earned on floating rate financial assets varies according to changes in bank deposit account interest rates.

Financial liabilities

The only financial liabilities of the Group are sterling finance leases, the maturity of which is disclosed in note 25. The interest rates on the finance leases are fixed and the average rate was approximately 17% for the year ended 31 December 2001.

Currency exposure of net monetary assets/liabilities

At each year end, the Group's currency exposures relate to receivables and payables in the Group, denominated principally in US dollars and translated into sterling at the rate of exchange at that date. The following table summarises the Group's material currency risk exposure at 31 December 2001:

	2001	2000
	£000	£000
US dollars—net assets	3,461	4,677
Euro—net assets/(liabilities)	654	(128)
Canadian Dollars—net liabilities	(6)	—
Swiss franc—net liabilities	(5)	(18)
Japanese yen—net liabilities	(50)	(3)

Fair value

In the opinion of the directors, there was no difference between the fair value of the Group's financial instruments and their carrying value. Fair values are assessed by reference to market values and discounted cash flows.

Borrowing facilities

At 31 December 2001 the company had no lines of credit or other borrowing facilities in place.

29 Related party transactions

During 1998, the Group entered into a contract with Lori Holland for the provision of consultancy services. Lori Holland became a director in 1999 and her emoluments and share options received as a director are reported on pages 15 and 16. In respect of her consultancy services, Lori Holland received £59,000 (2000 £55,000).

During 2001, £nil (2000 £1,309,000) was charged to the profit and loss account on revaluation of options received in respect of consultancy services which vested in 2000. Lori Holland exercised none of these options during 2001. All options had vested and 42,723 options were outstanding at 31 December 2001. Share and option numbers in this note do not reflect the six-for-one share split described in note 21.

30 Subsequent events

On 1 February 2002 the Company completed the acquisition of the business and assets of Marconi Optical Components Limited, a wholly owned subsidiary of Marconi plc, for a consideration of 12,891,000 Ordinary Shares.

31 Claims and Litigation

On 7 November 2001, a class action complaint was filed against the Company and others in the United States District Court for the Southern District of New York. The complaint names as defendants the Company; Goldman, Sachs & Co. and FleetBoston Robertson Stephens Inc., two of the underwriters of the Company's initial public offering in April 2000 (the "Underwriters"); and Andrew G. Rickman, Stephen J. Cockrell and David Simpson, each of whom was an officer and/or Director at the time of the initial public offering. The complaint asserts claims under certain provisions of the securities laws of the United States.

The complaint alleges, among other things, that the prospectus for the Company's initial public offering was materially false and misleading in describing the compensation to be earned by the Underwriters in connection with the offering, and in not disclosing certain alleged arrangements among the Underwriters and initial purchasers of ordinary shares from the Underwriters. The complaint seeks unspecified damages (or in the alternative rescission for those class members who no longer hold Ordinary Shares), costs, attorneys' fees, experts' fees, interest and other expenses. The Company believes it has meritorious defences and indemnification rights to such claims and therefore believes that such claims will not have a material effect on the Company.

32 Additional information for US investors

The consolidated financial statements are prepared in accordance with UK Generally Accepted Accounting Principles ("GAAP") which differ in certain material respects from US GAAP. Such differences, as presented below, involve methods for measuring the amounts shown in the financial statements, as well as additional disclosures required by US GAAP.

Reconciliation of US GAAP accounts to UK GAAP accounts

The following table provides a reconciliation of the loss for the financial year, total assets and equity shareholders' funds prepared under UK GAAP to the equivalent information prepared under US GAAP:

	UK GAAP	National Insurance	US GAAP
	£000	£000(a)	£000
Profit and loss account			
Loss for the financial year 2000	(29,065)	1,073	(27,992)
Loss for the financial year 2001	(113,238)	(907)	(114,145)
Balance sheet 2000			
Total assets	331,519	—	331,519
Equity shareholders' funds	304,062	988	305,050
Balance sheet 2001			
Total assets	228,624	—	228,624
Equity shareholders' funds	210,870	79	210,949

(a) National Insurance contributions on share option gains Under US GAAP, provision for National Insurance liabilities on share options is only made during the period to the extent that the options have been exercised. Under UK GAAP, provision is made at each balance sheet date by charging the expected future cost on a straight-line basis over the vesting period of the options.

(b) Non-employee compensation Under US GAAP, the fair value of warrants and options issued to non-employees is recognised as an asset and credited to a separate capital reserve on issue and taken to the profit and loss account over the period in which the related services are received. The non-employee stock compensation attributable to research and development, cost of net revenues, and selling and general administrative expenses is disclosed on the face of the financial statements. Under UK GAAP, the fair value is charged to the profit and loss account on the same basis as for US GAAP but the full credit is not immediately recognised in shareholders' equity. The charge to the profit and loss account is credited to other reserves each year.

(c) Consolidated statement of cash flows The US GAAP cash flow statement reports changes in cash and cash equivalents, which include short-term highly liquid investments. Only three categories of cash flow are reported, being: operating activities (including tax and interest); investing activities (being capital expenditure, acquisitions and disposals); and financing activities.

(d) Comprehensive income statement The requirement of FAS 130 to provide a comprehensive income statement is met by the Statement of total recognised gains and losses (page 20). If comprehensive income were presented in accordance with US GAAP, it would also include the net impact of gains and losses on equity and liquid investments. The Group did not hold any liquid investments during the year.

Condensed consolidated US GAAP financial information in UK sterling and US dollars

The following information is provided for the convenience of US shareholders. The sterling amounts have been translated solely for the convenience of the reader at the noon buying rate certified by the Federal Reserve Bank of New York on 31 December 2001 of US\$1.45 = £1.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNTS US GAAP

for the year ended 31 December 2001

	2000	2001	2001
	£000	£000	$000
Net revenues:			
Product	25,237	21,712	31,482
Development contracts	1,064	209	303
	26,301	21,921	31,785
Cost and expenses			
Cost of net revenues			
—Product	31,254	35,978	52,168
—Development contracts	596	125	181
Gross Loss	15,549	14,182	20,564
Research and development	17,355	39,152	56,770
Selling, general and administrative	13,875	15,830	22,954
IPRD		6,454	9,358
Impairment loss	—	48,879	70,875
National Insurance on stock options	171	127	184
Stock-based compensation	531	329	477
Total costs and expenses	31,932	110,771	160,618
Operating loss	(37,481)	(124,953)	(181,182)
Other income/(expense)			
Grant and other income	61	76	110
Interest income	10,144	11,405	16,537
Interest expense	(574)	(478)	(693)
Gain/(loss) on foreign exchange	(316)	(195)	(283)
Total other income, net	9,315	10,808	15,671
Loss before income taxes	(28,166)	(114,145)	(165,511)
Cumulative effect of change in accounting policy	174	—	—
Net loss	(27,992)	(114,145)	(165,511)
Net loss per ordinary share (basic and diluted) (£)	(0.24)	(0.89)	(1.29)
Weighted average ordinary shares outstanding	116,231,841	128,533,108	128,533,108
Stock-based compensation as below is excluded from the following categories:			
Cost of net revenues	138	87	126
Research and development	37	36	52
Selling, general and administrative expenses	356	206	299
Total	531	329	477

All income is generated from continuing operations.

CONDENSED CONSOLIDATED BALANCE SHEETS US GAAP

as at 31 December 2001

	2000	2001	2001
	£000	£000	$000
Assets			
Current assets			
Cash and cash equivalents	266,158	184,814	267,980
Restricted cash	450	—	—
Accounts receivable, net	9,009	822	1,192
Inventories, net	6,961	2,564	3,718
Prepaid expenses and other current assets	4,230	4,179	6,060
Total current assets	286,808	192,379	278,950
Intangible assets	447	1,666	2,416
Property and equipment, net	44,264	34,579	50,140
	331,519	228,624	331,506
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable	19,217	7,093	10,286
Short-term capital lease obligations	1,357	897	1,301
Accrued expenses and other liabilities	4,998	9,685	14,043
	25,572	17,675	25,630
Long-term capital lease obligations	897	—	—
Total liabilities	26,469	17,675	25,630
Shareholders' equity:			
Ordinary shares:			
1/3p nominal value; 161,700,000 and 200,100,000 authorised; 127,317,473 and 130,160,413 issued and outstanding	424	434	629
Ordinary share warrants and options issued to non-employees	1,552	3,939	5,712
Additional paid-in capital	368,470	385,630	559,164
Deferred compensation	(805)	(276)	(400)
Accumulated other comprehensive income	1	(39)	(57)
Accumulated deficit	(64,592)	(178,739)	(259,172)
Total shareholders' equity	305,050	210,949	305,876
	331,519	228,624	331,506

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW US GAAP

for the year ended 31 December 2001

	2000 £000	2001 £000	2001 $000
Cash flows used in operating activities:			
Net loss	(27,992)	(114,145)	(165,511)
Adjustments to reconcile net loss to net cash used in operating activities:			
In-process research and development	—	6,454	9,358
Depreciation, amortisation and impairment	4,607	59,726	86,603
Stock-based compensation	531	329	477
Expense related to warrants issued for services	1,603	173	251
Loss (gain) on sale of property and equipment	20	(8)	(12)
Assets and liabilities:			
Restricted cash	1,800	450	653
Accounts receivable, net	(7,193)	8,187	11,871
Inventories, net	(6,204)	4,397	6,376
Prepaid expenses and other current assets	(3,320)	51	74
Accounts payable	8,202	(3,136)	(4,547)
Accrued expenses and other liabilities	1,623	4,687	6,796
Deferred revenue	(276)	—	—
Net cash used in operating activities	(26,599)	(32,835)	(47,610)
Cash flows used in investing activities			
Purchase of intangible assets	(486)	(1,812)	(2,627)
Purchase of property and equipment	(28,280)	(39,896)	(57,849)
Proceeds from sale of property and equipment	31	96	139
Acquisitions of business—net of cash acquired	—	(6,796)	(9,854)
Net cash used in investing activities	(28,735)	(48,408)	(70,791)
Cash flows provided by financing activities			
Proceeds from issuance of ordinary shares	338,238	1,256	1,821
Issuance costs	(24,270)	—	—
Share subscriptions receivable	2	—	—
Repayment of capital lease obligations	(1,377)	(1,357)	(1,968)
Net cash provided by financing activities	312,593	(101)	(147)
Effect of exchange rate on cash	(1)	—	—
Net increase/(decrease) in cash and cash equivalents	257,258	(81,344)	(117,948)
Cash and cash equivalents at beginning of the year	8,900	266,158	385,929
Cash and cash equivalents at end of the year	266,158	184,814	267,980
Supplemental disclosure of non-cash transactions			
Property and equipment under capital leases	—	—	—
Warrants and share options issued for services	1,076	—	—
Supplemental cash flow disclosure			
Interest paid	374	281	407

ENVIRONMENTAL STATEMENT

Quality management

Bookham Technology is committed to providing integrated optical components to the highest standards, to meet and exceed customer requirements. To help achieve these goals the Group uses a quality management system developed to meet the requirements of ISO 9001 and TL 9000. TL 9000 is the telecom-specific quality management system and Bookham Technology was the first European-based company to receive accreditation to this system in October 2000. All products in the ASOC range are designed to meet Telcordia reliability standards. Dedication to such quality systems will result in the best possible solutions for our customers.

The environment

We consider respect for the environment an integral business responsibility. To this end we encourage all employees to take an interest in the protection of the environment. The Group ensures the following steps are taken:

- As a minimum, we comply with the appropriate legislation, regulations and codes of practice.
- We identify and evaluate any environmental effects associated with the infrastructure and supply of integrated optical components, in order to control and reduce their environmental impact.
- We regularly set and review challenging environmental objectives and targets.
- We ensure the responsible use of all natural resources and the minimisation of waste, pollution and energy consumption.
- We implement the training of all employees to ensure that they are environmentally aware and that neither they, the community nor the environment are exposed to harm as a result of our operations.

Bookham Technology is committed to the continual improvement of its performance by the monitoring of environmental issues and through involvement with suppliers, customers, regulatory authorities and the community.

DISCLAIMER

Forward-looking statements

Statements made in this financial commentary and elsewhere in this report include certain forward-looking statements that involve risks and uncertainties. Important factors that could cause actual results to differ from those indicated by such forward-looking statements include, among others, uncertainties relating to demand for the Group's products, demand for optical components generally and overall future growth in the market for optical components, uncertainties relating to the Group's investment in, and reorganisation of, its manufacturing capacity, production equipment and personnel and related impact on profitability, quarterly variations in financial results, manufacturing capacity yields and inventory, intellectual property issues, issues surrounding integration of the optical components business acquired from Marconi and other uncertainties that are discussed in the "Risk Factors" section of the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2001, which will be on file with the Securities and Exchange Commission and the "Risk Factors" section of the Group's Annual Report on Form 20-F dated May 25, 2001 which is on file with the Securities and Exchange Commission. Forward-looking statements represent the Group's estimates as of the date made, and should not be relied upon as representing the Group's estimates as of any subsequent date. While the Group may elect to update forward-looking statements in the future, it disclaims any obligation to do so.

ADDRESSES

UK Headquarters

Bookham Technology plc
90 Milton Park
Abingdon, Oxfordshire
OX14 4RY, UK
Tel: +44 1235 837 000
Fax: +44 1235 827 201

UK

Bookham Technology plc
Unit 100
Faraday Park
Dorcan
Swindon
SN3 5JF, UK
Tel: +44 1793 714 700
Fax: +44 1793 714 701

UK

Bookham Technology plc
Caswell
Towcester
Northamptonshire
NN12 8EQ, UK
Tel: +44 1327 350 581
Fax: +44 1327 356 698

US Headquarters

Bookham Technology Inc
9140 Old Annapolis Road
Route 108, Columbia
Maryland 21045
USA
Tel: +1 410 964 4000
Fax: +1 410 992 5813

France

Bookham Technology plc
Atria Paris-Charenton
5 Place des Marseillais
94227 Charenton le Pont
Cedex, France
Tel: +31 1 4676 6017
Fax: +31 1 4676 6004

Japan

Bookham Technology KK
KSP W300C
3-2-1 Sakado
Takatsu-ku,
Kawasaki 213-0012
Japan
Tel: +81 44 850 8800
Fax: +81 44 850 8801

Italy

Bookham Technology plc
Vin Ippolito Nievo 11
20145 Milano
Italy
Tel: +39 02 4331 5959
Fax: +39 02 4399 5856

China

Bookham Technology plc
Rm 4206, Tower A
United Plaza
5022 Binhe Road
Shenzhen 518026
China
Tel: +86 755 2910288
Fax: +86 755 2910388

Contact details

www.bookham.com

E-mail contacts

Sales enquiries:
sales@bookham.com
Media enquiries:
media@bookham.com
Marketing:
marketing@bookham.com
Investor Relations:
investors@bookham.com
Human Resources:
hr@bookham.com

Stock data

Bookham Technology is traded on US Nasdaq (BKHM) and the London Stock Exchange (BHM)

Company registered number: 02298887

Advisers

Brokers
Goldman Sachs International
Peterborough Court
133 Fleet Street
London
EC4A 2BB

Joint US and UK Legal Advisers to the Company
Brobeck Hale and Dorr
Alder Castle
10 Noble Street
London
EC2V 7QJ

Registered Auditors and Reporting Accountants
Ernst & Young LLP
Apex Plaza
Reading
RG1 1YE

Principal Bankers
Barclays Bank plc
Oxford Corporate Banking Centre
Wytham Court
11 West Way
Oxford
OX2 0XP

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www.bookham.com