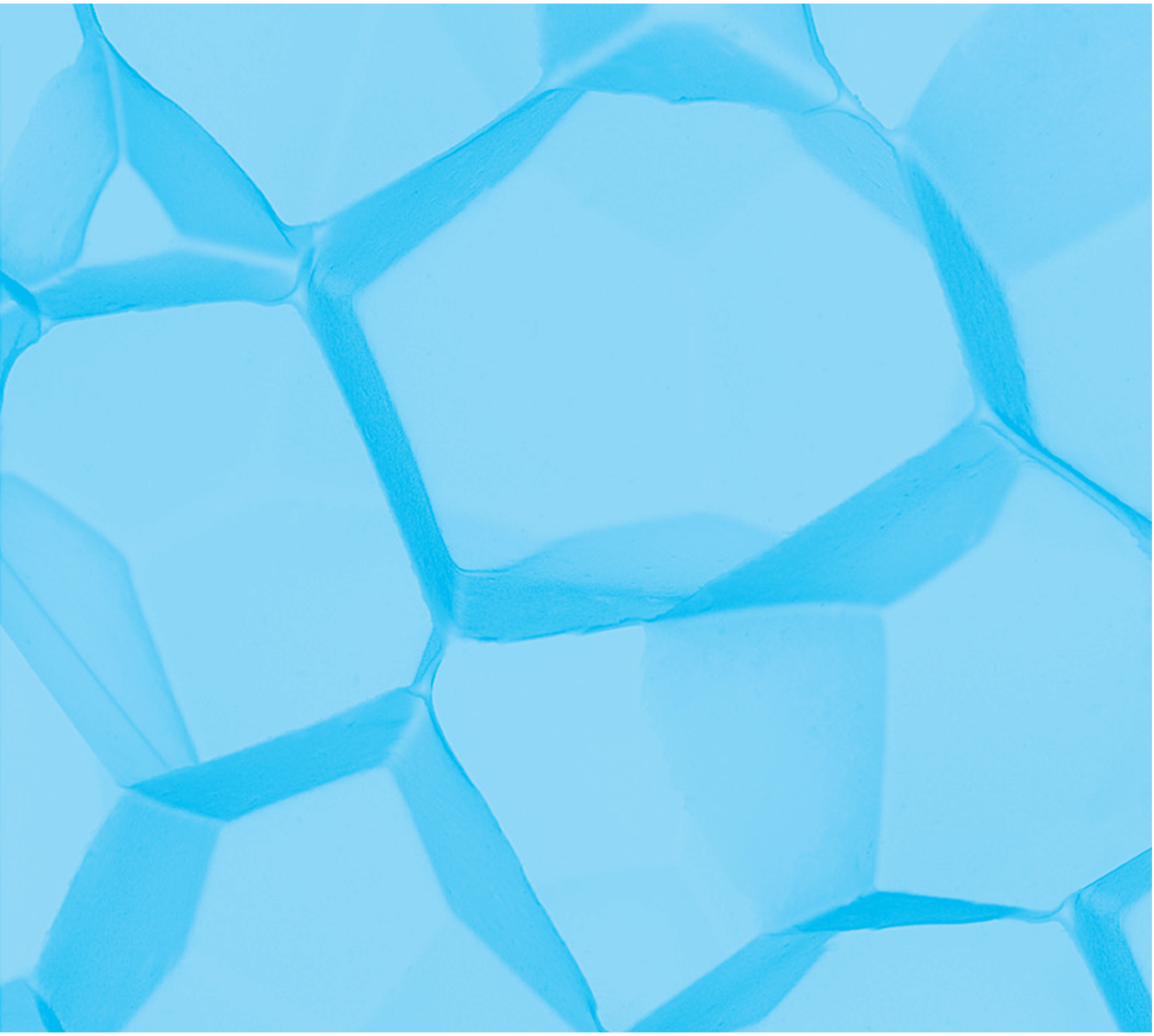
ZOTEFOAMS

# Annual Report and Financial Statements 2007

## High Performance Foams for Specialist Markets Worldwide



# Welcome to Zotefoams

Zotefoams is the world's leading manufacturer of cross-linked block foams. The global appeal of its high-performance foams ensures that Zotefoams' products are used in a wide range of markets including sports and leisure, packaging, aerospace, automotive, medical and construction as well as general industrial and consumer products.

Our strategy is to expand sales internationally and broaden our market appeal with unique new products supported by our commitment to quality, innovation and customer service.

We are focused on achieving this while continuing to improve our operating margins, our return on capital employed and delivering our prime goal of sustained profit growth.

**Front cover image**
Plastazote LD30SD cell structure magnified using a Philips XL-40 scanning electron microscope at 10 micron resolution.

**Contents**

# Highlights

## Outlook

The polyolefin business performed well in 2007 and trading for the first two months in 2008 is in line with our expectations. Development of high-performance polymers continues to progress and offers many exciting opportunities. The Board continues to be positive about the future.

### +5%

Revenue increased 5% to £31.6m

### +26%

Profit before tax, excluding exceptional items, increased 26% to £3.37m

### +2%

Operating margin, before exceptional items, increased to 11% (2006: 9%)

### Polyolefins

Strong sales growth, particularly in Europe and Asia

### High performance

High-performance polymers sales of £734,000, up 49%

**Forward-looking statements**

This document contains statements that are not historical facts, but forward-looking statements that involve risks and uncertainties, including the timing and results of technical trials, product development and commercialisation risks, the risks of satisfying the regulatory approval process in a timely manner and the need for and the availability of additional capital. A discussion of these and other risks and uncertainties is contained in the Directors' Report under the section entitled 'Risks and Uncertainties'. These forward-looking statements are based on knowledge and information available to the Directors at the date the Directors' Report was prepared, and are believed to be reasonable at the time of preparation of the Directors' Report, though are inherently uncertain and difficult to predict. Actual results or experience could differ materially from the forward-looking statements.

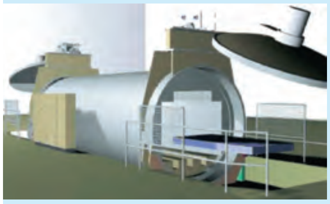
# Why Zotefoams?

Manufactured using pure nitrogen, in a unique process, our foams have significant advantages over competitive products. Zotefoams materials are lightweight, pure, low-odour, low-stress and have strong aesthetic appeal thanks to their deep colours and rich textures. They are both easy and economical to process and provide add-value opportunities for converters around the world.

## A unique process

**Stage 1**
Extrusion and cross linking of polymeric sheet.

**Stage 2**
Impregnation of polymer sheets with pure nitrogen at high temperatures and pressure.



**Stage 3**
Final expansion of impregnated solid sheet to form foam.

> Quality
> Purity
> Strength
> Consistency

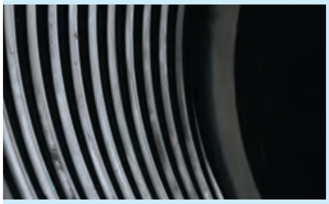
The superiority of Azote and ZOTEK foams stems directly from the use of this high-pressure gas technology.

It produces pure, low odour, chemically inert foams without blowing agent residues and with a uniform cell structure and regular cell wall, a combination of beneficial features and flexibility that cannot be achieved by any other production method.

## Technology with a purpose

Close control over the individual parameters of the three stage manufacturing process enables us to change the physical attributes of the finished foams.

State-of-the-art extrusion technology enables advanced engineering polymers to be processed alongside an increasing range of polyolefin's. Cross linking occurs at this process stage allowing the finished foams to be heat-moulded with outstanding results.



Advanced high-pressure autoclave technology enables us to foam polyoefins down to densities that no other foaming process can achieve and allows us to foam engineering polymers that simply cannot be foamed by other methods.

Low pressure autoclave technology allows close control over finished foam density. Expansion in a free environment ensures isotropic properties allowing easier conversion and manipulation.

Foams produced by the Zotefoams nitrogen expansion process are characterised by their regular cell size and architecture, high purity and clean structure. There are no chemical residues to detract from the performance of the foams.

# Our Brands

Zotefoams has several strong brands that are widely acknowledged in the markets they serve, some having become bywords for all that is best in quality, consistency and performance.

## Powerful brands

Zotefoams has two strong brands, AZOTE® and ZOTEK®, which offer significant marketing opportunities in a diverse portfolio of applications across many industries.

## Azote®

AZOTE® is the group brand name for Zotefoams' polyolefin foams. These are high quality foams from differing base polymers but all manufactured using the same unique nitrogen expansion process route.

AZOTE® was used formerly as a name for nitrogen and is still used by French chemists to refer to the element. AZOTE® foams derive many of their exceptional properties directly from the use of this inert, tasteless, odourless gas in the manufacturing process.

Zotefoams' well known product brands names; PLASTAZOTE®, EVAZOTE®, SUPAZOTE® and PROPOZOTE® will continue to stand for individual product types within the overall AZOTE® product range.

**Plastazote®**
**Evazote®**
**Supazote®**
**Propozote®**

## ZOTEK®

ZOTEK® foams are a range of high performance foams manufactured, using Zotefoams' unique high-pressure nitrogen gas solution manufacturing process, from fluoropolymers and engineering polymers.

ZOTEK® F is a range of lightweight, closed cell foams based on the fluoropolymer Kynar® PVDF (polyvinylidene fluoride). It is a remarkable material that offers a unique balance of properties including temperature, UV and chemical resistance combined with excellent flammability performance.

ZOTEK® N is a range of lightweight, closed cell foams, based on the engineering thermoplastic polyamide. The main benefits of polyamide are its thermal and chemical resistance. Polyamide is particularly resistant to swelling by hydrocarbons such as oils, which combined with its thermoplastic nature allow complex shapes to be fabricated economically.

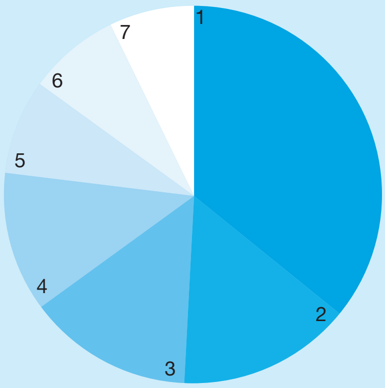
**ZOTEK® F**
**ZOTEK® N**

# Our Strength is the Breadth of Applications

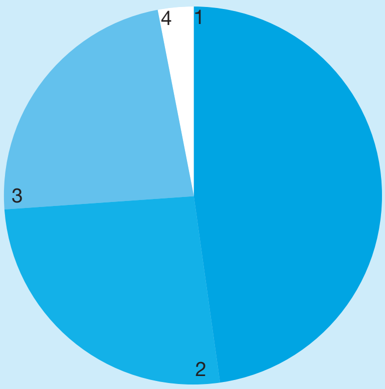
Our ability to control and vary the physical properties of our foams enables us to offer a wide range of materials with a broad spectrum of performance attributes. These attributes have led to our foams being used in a vast number of fundamentally unrelated applications across a wide spread of industries.

## % Revenue analysis

**Revenue by Market Sector**
1 Packaging **36%**
2 Industrial **15%**
3 Aerospace and Automotive **14%**
4 Sport and leisure **12%**
5 Construction **8%**
6 Medical **8%**
7 Other **7%**




**Revenue by Region**
1 Europe **48%**
2 UK and Eire **26%**
3 North America **23%**
4 Rest of World **3%**




## Market applications

**Pharmaceutical Packaging**
The combination of high purity and light weight makes Plastazote an ideal material for use in cosmetic, pharmaceutical and neutraceutical packaging applications.

Certain Plastazote grades have been shown to comply with The American Food and Drug Administration's food contact regulations and details have been submitted to the FDA DMF Database. A current application for this type of material is as an expandable ullage filler to prevent coated pills becoming damaged during transport and handling.

**Medical**
Because of its outstanding purity, Azote foams are utilised in a variety of medical applications from packaging to trauma protection. The material is by nature MRI, CT and X-Ray lucent, a property vital to the success of many diagnostic procedures.

In addition to its use in the manufacture of prosthetics, and orthotics, the material is used to produce a variety of active and passive support elements for use in MRI scanning.

Foam mats manufactured by Imbema Kunststofchemie B.V.

**Sport and Leisure**
Azote foams are used widely in sport and leisure applications from back packs to body protectors, helmet liners to handlebar pads, paddle rackets to Pilates barrels.

The low odour, excellent energy absorption and outstanding skin compatibility of the material has encouraged its selection as the prime material for the manufacture of martial arts combat arenas, camping mats and exercise mats.

**Industrial**
Foams from Zotefoams are used in a wealth of industrial applications and are held in high esteem for their insulating, sealing, impact protecting and lightweight properties.

Plastazote is used to insulate the copper, refrigerant pipeline components in the world's leading VRV air conditioning and heat recovery systems because of its good insulation properties, its inert nature and its outstanding machinability.

**Military**
Azote foams are used extensively for military purposes from rifle case inserts to helmet liners, and ordnance cradles to thermoformed back supports for ejector seats in fighter aircraft.

A range of materials is available, tested and approved to UK Defence Standard and US Military Specification requirements.

**Construction**
Evazote is the material of choice for the manufacture of expansion joints for bridges, roadways, airport runways, water treatment plants, viaducts, major sporting stadia and other commercial structures.

Evazote provides waterproofing as well as maximum movement capabilities to an expansion joint and is particularly suited where seismic conditions are a design consideration.

# Personal Protection

## Smart Cap 'reinvents' sports head protection with help from Azote foam

Participants in many action sports, from speed skating to snow boarding, skiing to kite surfing, prefer not to wear a conventional helmet. Weighing only 116 grams, Smart Cap is a brand new, flexible alternative for those who would choose comfort and style over maximum protection.

The Plastazote HD 115, from which the Smart Cap core is made, offers good impact protection but the unique, "flexible shell" design enables it to be folded and packed flat in a back-pack for convenience.

Smart Cap can be worn with a variety of covers that enable wearers to personalise their headgear… ensuring that fashion and protection are not mutually exclusive.

Information and image courtesy of Smart Cap/Leidel & Kracht.

## Aviation and Aerospace

### ZOTEK F PVDF foam achieves airplane manufacturer's approval

ZOTEK F foam, based on Kynar® PVDF, is used increasingly in civil, business and military aviation. It exhibits outstanding smoke, toxicity and flame characteristics and has a closed cell structure, giving low water absorption and low water vapour permeability, excellent insulation characteristics and good durability, allowing both long life and flexibility when fabricating parts.

Working closely with a major airplane manufacturer, Technifab, one of Zotefoams' designated aerospace licensees is converting the basic PVDF foam into various part configurations, including insulation tubes, gaskets, seals and other specialty aerospace components.

Information and image courtesy of Technifab Inc.

# Returnable Transit Packaging

## Azote foams in long life re-usable packaging

In the quest for 'zero waste packaging', many automotive manufacturers and tier one suppliers use plastic tote boxes with routed or die-cut Plastazote inserts for returnable line-side packaging.

Inserts machined from Plastazote are durable and long lasting and require no expensive tooling to produce. They combine outstanding protection with the correct amount of grip for ease of access and are even suitable for delicate and expensive components and 'A'-surface finishes.

One of the world's largest car manufacturers has been so impressed with the performance of Plastazote that the product is now being included by name in the company's packaging specifications.

Information and image courtesy of MSA Foams Limited.

Photo © Jock Fistick / Axis-5 Images

# Transport

## ZOTEK N takes the heat in new tipper trailer body

Increasingly, ZOTEK N is being evaluated for use in automotive engine compartment projects where its high temperature resistance and excellent resistance to oils and greases are fast becoming recognised.

A recent commercial vehicle application is for the insulation of asphalt tipper trailer bodies. Being extremely durable and tolerant of high temperature conditions, ZOTEK N is proving to be the ideal insulation material.
It is able to reduce the heat loss during transit and to protect personnel, when the vehicle is stationary, by keeping the outer surfaces cool.

Information and image courtesy of Sundolitt AB.

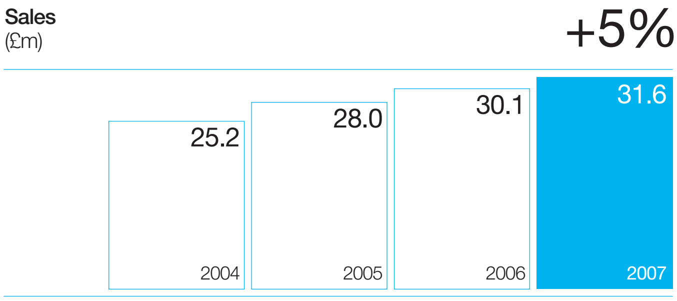
# Chairman's Statement
## by Nigel Howard

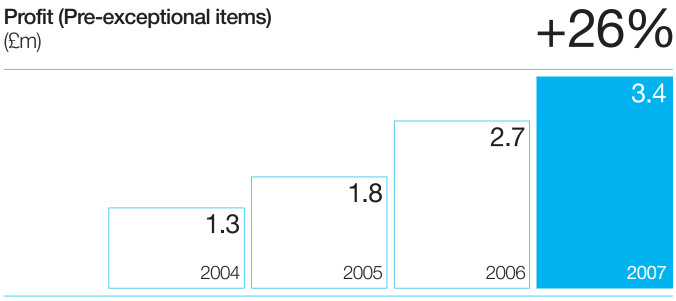
**Nigel Howard**
Chairman

We will seek to profitably expand through a combination of organically growing both our polyolefin and high-performance polymers businesses and through partnerships or acquisitions in related technologies, products or markets.

### Strategy
Zotefoams' strategy is to grow our existing business in polyolefin foams while developing a portfolio of high-performance polymers. We will seek to profitably expand through a combination of organically growing both our polyolefin and high-performance polymers businesses and through partnerships or acquisitions in related technologies, products or markets.

### Objectives
We intend to grow sales in our core polyolefin business in excess of the rate of inflation in Europe and achieve double digit percentage growth in North America and Asia. Our sales growth in America is supported by our factory in Kentucky which opened in mid-2001 while in Asia we will consider a similar operation, either under a license or as a joint venture, as sales increase to a level where such an investment becomes financially attractive. We are also committed to developing a portfolio of unique foam products from high-performance materials which will enjoy significant advantages over competitive materials. This will allow higher margins for Zotefoams and confirm our position as the pre-eminent foam technology company. We intend to achieve this growth while continuing to improve our operating margins and our return on capital employed.




## Board

Chris Ryan, who joined Zotefoams in 1999 as a non-executive director, resigned from the Board effective 31 December 2007 after eight years service. On behalf of the Board I would like to thank Chris for his service and contribution over the years. On 23 July 2007 Richard Clowes joined the Board as a non-executive director. Richard is a chartered engineer with wide ranging operational and general management experience in supplying components to, amongst others, the aerospace and automotive markets. He was a main Board Director of GKN plc from 2001 to 2005. I am delighted to welcome Richard to the Board. With Richard, David Campbell (the ex-Chief Executive of British Vita) who joined the Board in February 2007 and Roger Lawson (who was a director of 3i) I believe that we have a strong and balanced team of non-executive directors to support the executive in moving the business forward.

## Employees

Our business relies on our employees and on behalf of the Board I would like to thank all of our employees whose talents, efforts and dedication combined to make 2007 a successful year.

## Our Achievements

During 2007 we grew profit before tax and exceptional items by 26% to £3.37m (2006: £2.67m) and sales increased by 5% to £31.61m (2006: £30.05m). There were no exceptional items in 2007 (2006: a charge of £1.07m) and profit before tax after exceptional items was therefore £3.37m (2006: £1.60m). Sales growth in the second six months of the year was particularly pleasing with continued progress in Europe and Asia and a recovery seen in North America. Gross margins in 2007 increased to 27.1% (2006: 25.9%) and Group operating margins improved from 9% to 11% of sales. Our commitment to development of our high-performance products business was reinforced with a landmark deal with UFP Technologies of USA, a key Zotefoams customer, to act as distributor for their T-Tubes® product line, made from our ZOTEK® fluoropolymer foam, in Europe and Asia.

## Dividend

We are proposing a maintained final dividend of 3.0p per ordinary share which if approved, would make a total of 4.5p per ordinary share for the year (2006: 4.5p). At this level the dividend would be covered 1.5 times by post-tax earnings excluding one-off tax items. The Board's priority is to retain the capability to support the growth opportunities within the business while considering an improved dividend policy as dividend cover increases.

## Outlook

The polyolefin business performed well in 2007 and trading for the first two months in 2008 is in line with our expectations. Development of high-performance polymers continues to progress and offers many exciting opportunities. The Board continues to be positive about the future.

**Nigel Howard**
Chairman
3 March 2008

# Business Review
## by David Stirling & Clifford Hurst

**David Stirling**
Managing Director

**Clifford Hurst**
Finance Director

During 2007 we grew profit before tax by 26% and sales increased by 5%.

Zotefoams is the world's leading manufacturer of cross-linked block foams. Its products are used in a wide range of markets including sports and leisure, packaging, automotive, aerospace, healthcare, construction, marine and the military. Through a unique production process, the Company produces foams which have controlled properties and are of a strength, consistency, quality and purity superior to foams produced by other methods.

### Business Overview
Zotefoams considers its business to fall into two distinct categories: polyolefin foams and high-performance polymers. Both businesses rely on our unique production process which uses nitrogen gas at high temperature and pressure to foam solid plastics. Polyolefin foams are mainly made from polyethylene which, when foamed, produces a versatile material used in a wide variety of applications. Typically our products are sold to foam converters who process the foam by a variety of techniques such as cutting, welding, moulding and routing into finished or semi-finished parts based on end-user requirements. The benefits of Zotefoams' products are evident at both foam processors and end-users and include purity, consistency of processing, good performance to weight ratio and aesthetics. Key to growing our business successfully is developing and maintaining close relationships with the converters combined with business development activities at end-users to highlight the benefits of our materials and track industry trends for future development.

High-performance polymers use the processing technology developed for polyolefin foams and applies it to other materials. This is an emerging business which offers an improved return on capital in new business segments. We have developed, patented and launched world leading products made from fluoropolymer and nylon which are branded "ZOTEK®"- our high-performance foams' trademark. These foams are targeted at highly technical and demanding applications in markets such as aerospace, pharmaceutical, semi-conductor, chemical processing and automotive where market development lead times are long. The timing of revenue generation is therefore difficult to predict.

## Financial Results

The 5% increase in Group sales was mainly due to a 4% volume increase in polyolefin foams. Growth in high-performance polymer foams increased Group sales by 1%. Movements in foreign currency exchange rates reduced sales by 2% although these were offset by price rises and changes in product mix. Gross margin increased to 27.1% from 25.9% with savings in sales commissions and manufacturing costs more than offsetting increases in raw material and energy prices.

Distribution costs (which include selling expenses) rose by 11% as we continued to increase our sales resources in both polyolefins and high-performance polymers. Administrative expenses are net of a foreign exchange gain of £0.23m (2006: loss of £0.15m). Profit before tax increased by 26% to £3.37m (2006: £2.67m before exceptional items). Profit before tax after exceptional items was £3.37m (2006: £1.60m).

The overall effective tax rate is 13% (2006: 26% before exceptional items). The decline was due to a £0.20m reduction in the Group's deferred tax liability following a change in the rate at which the Group's future corporation tax liabilities are provided for and a £0.23m favourable adjustment to the tax charge in respect of prior periods. Excluding these two items, the effective tax rate is 26%.

### Earnings per share and Dividend

Group earnings per share after exceptional items were 8.0p (2006: 5.5p excluding exceptional items). The Directors are recommending that the final dividend is maintained at 3.0p per share payable on 22 May 2008 to shareholders on the Company register at 25 April 2008. This would bring the total dividend to 4.5p per ordinary share for the year (2006: 4.5p).

### Cash Flow

Cash generated from operations was £4.78m (2006: £4.72m) after a £1.29m increase in working capital. The working capital increase reflected the higher sales activity in the second half of 2007 and the final instalment payment of £0.48m to terminate a distribution agreement (the termination cost was taken as an exceptional item in 2006). Capital expenditure of £2.69m was similar to last year. During the year the Company paid £0.24m to purchase 196,330 of its own shares. After the dividend payment of £1.64m the net cash outflow amounted to £0.25m, increasing net debt to £1.68m (2006: £1.43m). Gearing remains low at 6% (2006: 6%).


Rotating door mechanism for high pressure gassing process.

## Strategy and Objectives

**Zotefoams' strategy is to grow our existing business in polyolefin foams while developing a portfolio of high-performance polymers.**

| **Our stated objectives are to:** | **Performance in 2007 against these objectives was:** |
|---|---|
| 1. Grow sales in our polyolefin business: | 1. Sales: |
| a. In excess of the rate of inflation in Europe. | a. Polyolefin sales in the UK and Europe grew by 7% which was significantly above the average inflation rate. |
| b. Achieve double digit percentage growth in North America. | b. Polyolefin sales in North America fell by 1% in constant currency. Polyolefin sales growth of 19% in the second half of 2007 compared to the second half of 2006 almost entirely reversed the decline seen in the first six months of the year. |
| c. Achieve double digit percentage growth in Asia. | c. Polyolefin sales in Asia grew by 96%. We stated that 2006 would be a year of transition, exiting a regional distribution agreement and forming more direct relationships with foam converters and end-users. The results for 2007 vindicate this approach and we believe that Asia offers significant potential for growth in niche, higher added-value products. We are therefore focusing our resources on these products and have recently recruited additional sales resource for this territory. |
| 2. Develop a high-performance polymers portfolio to deliver enhanced margins. | 2. Sales of high-performance polymers grew by 49%. (59% after adjusting for movements in exchange rates). |
| 3. Improve our operating margins. | 3. Group operating margins, pre-exceptional items, improved from 9% to 11% of sales revenue. |
| 4. Improve our return on capital employed. | 4. Pre-tax return on capital employed, pre-exceptional items, increased from 11% to 13%. |

# Business Review continued

## Markets and Operations

In 2007 overall sales grew by 5% to £31.61m (2006: £30.05m).

The polyolefin foams business grew to £30.87m (2006: £29.56m). Overall the polyolefin foams market is relatively mature and growth comes from focused development in more specialist areas. Our sales and marketing approach recognises this and our sales teams work closely with customers to identify areas of opportunity and support them in their approach to these areas. This structure, with a direct sales organisation to service all customers, is showing good progress particularly in continental Europe where sales grew by 6% and Asia where sales grew by 96%. These areas, until March 2006, were managed by an agent and a distributor respectively and the cost of exiting these relationships was shown as an exceptional item in 2006. In the UK sales by increased 8% with a combination of volume growth and a stronger product mix. In North America, where our business has been affected by a weaker economy, sales declined by 1% in US dollars as sales growth of 19% in the second six months of the year offset the poor result in the first six months of 2007.

The benefits of Zotefoams' products are evident at both foam processors and end-users and include purity, consistency of processing, good performance to weight ratio and aesthetics.

Our high-performance polymers ("HPP") are unique foams produced for technically demanding applications. They offer properties such as improved chemical resistance, fire retardancy or temperature performance compared to other foam materials.
The applications for these products are often much larger in value than a typical polyolefin foam application, however the performance requirements and test conditions are very demanding and evaluation can take many months or sometimes years. Therefore the inherent uncertainty of such projects, particularly their timing and the unique requirements of specific applications which will vary from project to project makes projecting revenues and success rates extremely difficult, especially at this early stage of their development.

In 2007, HPP sales were £734,000, an increase of 49% over the previous year. The majority of these sales were ZOTEK® F fluoropolymer grades of foam in aerospace and clean-room insulation applications, although other projects are under development which use their unique combination of fire-retardancy, purity and chemical resistance. Particularly pleasing was a contract awarded in February 2008 to Technifab Inc. a long-standing customer based in Ohio, USA for supply of fabricated foam gaskets for the Boeing 737 programme.

As our HPP business develops we are investing significantly in both technical and marketing resource. During 2007 we increased sales and marketing expenditure to investigate and develop markets for our ZOTEK® N B50 polyamide (nylon) foam, a high temperature material with the capability to be heat moulded. Development of a second product in the ZOTEK® N range, with a softer feel for specific application requirements, is close to completion with launch anticipated in the next few months.

In August 2007 we signed a distribution agreement with UFP Technologies Inc. under which Zotefoams will act as distributor in Europe and Asia for the T-Tubes® brand of advanced insulation made from a specific grade of ZOTEK® F foam which in October 2007 received an industry standard approval for clean room insulation use. This is a significant partnership approach to development of a new market with a key customer where Zotefoams will act as the direct sales contact for an end-user market for the first time.

# Scope of Operations Worldwide

| | Croydon, UK | | | Kentucky, USA | |
|---|---|---|---|---|---|
| | Azote | ZOTEK | T-Tubes | Azote | ZOTEK |
| **Manufacturing Process** | | | | | |
| Extrusion | • | • | | | |
| High Pressure Gassing | • | • | | | |
| Low Pressure Expansion | • | • | | • | |
| **Sales & Marketing Responsibility** | | | | | |
| Europe | • | • | • | | |
| Asia | • | • | • | | |
| North America | | | | • | • |
| Other Areas | • | • | • | | |

Zotefoams operates from two sites: Croydon UK and Northern Kentucky, USA. Our site in Kentucky receives intermediate materials from the UK and processes them into Azote® polyolefin foams for the North American market. From our Croydon site we supply Azote® foams to all locations outside North America, intermediate Azote® products to our "satellite foaming plant" in Kentucky and ZOTEK® foams for worldwide sale. With sufficient capacity in Kentucky for the foreseeable future our capital program for capacity increases and process capability enhancement is focused on our Croydon plant. During 2007 we spent £2.69m on capital expenditure which included the completion of the refurbishment and upgrade of another of our large high-pressure vessels. This reduces to approximately 20% the proportion of our high-pressure capacity which operates on a water-cooling mechanism where corrosion accelerates the need for refurbishment. There remains one large high-pressure vessel which has not been refurbished and, as part of an ongoing programme to minimise the risks associated with corrosion, this vessel will be removed from production and inspected within the next few months.

Our major raw materials are commodity polymers and therefore are subject to rapid and sometimes large price movements. However in 2007 the price of low density polyethylene, by far our largest raw material cost, remained relatively stable during the year with Euro prices averaging a 2.6% increase over 2006.

Purchasing bulk raw materials in Euros helps to offset the natural currency exposure of the business where we typically sell in the currency of the customer. As approximately 75% of our sales are to non-UK customers, denominated mainly in Euro and US Dollars, we are exposed to foreign exchange movements. The Group experienced adverse movements in average exchange rates before currency hedging during 2007. At the average rates effective in 2006, sales would have been approximately £0.5m higher and operating profit approximately £0.4m higher. This was partly offset by a net £0.2m foreign exchange gain in administrative costs which includes the effects of the Group's hedging policy.

Energy costs have a significant impact on our business with energy costs amounting to 7% of Group sales. In March 2007 we renewed our UK energy contract fixing prices for two years from 1 December 2007 to 30 November 2009 allowing certainty of input prices on which to base our relationship with customers.

# Business Review continued

Our high-performance polymers ("HPP") are unique foams produced for technically demanding applications. They offer properties such as improved chemical resistance, fire retardancy or temperature performance compared to other foam materials.

## Risks and Uncertainties

Zotefoams' business and share price may be affected by a number of risks, not all of which are in our control. Zotefoams has a process by which such risks are identified, assessed and managed and this is set out in the Corporate Governance Report. Sections of the annual report contain forward looking statements, including statements relating to future demand for the Group's products, research and development, liquidity and cash resources. These forward looking statements involve risks and uncertainties, because they relate to events that may or may not occur in the future. Zotefoams' management believe the specific risks which are set out below are the principal risks, as identified under our risk management process, which could affect our profits, assets and reputation. However, other risks may also adversely affect the Group. Accordingly actual results may differ materially from anticipated results because of a variety of risk factors including: changes in global, political, economic, business, competitive and market forces; changes in legislation and tax rates; future business combinations or disposals; relations with customers and customers credit risk; events affecting international security, including global health issues and terrorism; changes in the regulatory and safety environment and the outcome of litigation.

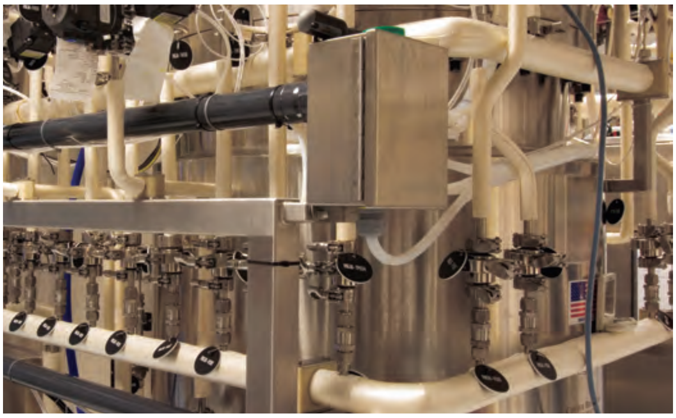
### Operational Disruption

Zotefoams' business is dependent on the ongoing operation of manufacturing facilities. Any significant operational disruption could impact our ability to manufacture and supply products. The Directors consider the Company's extensive Safety, Health and Environment ("SHE") policies and procedures to be the main mitigating controls around these risks. These are described in more detail in the Corporate and Social Responsibility Report on page 28. The Group also holds insurance which is designed to cover capital reinstatement and loss of profits in the event of operational disruption caused by certain events.

We use pressure equipment which is operated under the Pressure Systems Safety Regulations 2000 and SAFed ("best practice" system) which requires systematic internal and frequent external inspections.

### Supply Chain Disruption

Certain raw materials are currently only available from single sources. Inability to source these materials may result in an inability to supply products to our customers. Zotefoams seeks wherever practical to purchase materials from more than one source but the highly specified nature of our product lines means this is not always possible. We therefore monitor the situation closely and maintain "desk-top" studies of alternate materials which may be offered to our customers as substitutes.



T-Tubes® clean room installation at a major US biotechnology company.

Osprey aircraft utilising Zotefoams low density, high strength material for internal component systems.

### Technological Change and Competitor Activity

Market demand for our products depends, in part, on availability of suitable alternatives.
Any significant change in competitor activity or a technological change which brings new or enhanced products to the market may result in a change in demand for our products. Zotefoams maintains close contacts with existing customers and end-users to understand market activity and trends and has a constant flow of product variants developed for specific projects to maintain and enhance our position with our customers. We are developing a portfolio of high-performance polymers which are unique and protected by both patents and process capability. We believe these products will open up new markets with a significant and lasting differential advantage for the Group.

### Foreign Exchange

Zotefoams mainly sells in the local currencies of the customer and in 2007 approximately 75% of our revenue was in currencies other than sterling, particularly euros and US dollars. Our manufacturing assets and costs, including capital expenditure, are substantially in the UK and therefore sterling denominated, although we do have US dollar costs associated with our facility in Kentucky, USA and the majority of our raw material purchases are denominated in euros. The net impact of this is that we generate surpluses in euros and US dollars which we convert to sterling. We manage this risk firstly by converting all purchases to either euros or US dollars wherever sensible.
This reduces our net exposure and transaction costs of converting from one currency to another. The Group hedging policy to deal with the remaining risk is set out in note 20 of the financial statements.

### Pension Liabilities

Zotefoams operates a Defined Benefit Pension Scheme (the "Scheme") with retirement benefits being based on final salary. The value of scheme liabilities and assets along with the assumptions used in this valuation, are disclosed in note 22 of the financial statements. Any change in the assumptions used or where the actual outcome varies from these assumptions may have a significant effect on the liabilities or assets which, ultimately, may be the responsibility of the Company.

We have taken steps to minimise the risk to the Company by closing the Scheme to new members in 2001 and closing it to future accrual of benefits in 2005. In 2005 the Company agreed with the Trustees to pay £50,000 per month into the Scheme from January 2006 until December 2010 which, based on actuarial projections under assumptions made then, is designed to eliminate the projected deficit in the Scheme on an ongoing actuarial valuation basis. This will be reviewed after the next triennial actuarial review which will take place in April 2008.

**David Stirling** Managing Director
**Clifford Hurst** Finance Director

3 March 2008

# Directors and Advisers






**1. Nigel Howard BSC ARCS*#**
Non-executive Chairman and Chairman of the Nominations Committee, age 62

Joined the Board in January 2006 and was appointed Chairman in January 2007. Previously a Director of Morgan Crucible Plc where he worked for over 36 years in a number of roles including Interim Chief Executive. He is a non-executive Director of Alliance One International Inc. which is listed on the New York Stock Exchange and is a graduate of Harvard Business School ISMP Program.

**2. David Stirling BSC CA MBA MSC**
Managing Director, age 41

Joined Zotefoams plc in September 1997 as Finance Director. Appointed Managing Director in May 2000. Previously with BICC plc, Price Waterhouse in USA and Poland and KPMG. A graduate of Warwick and London Business Schools.

**3. Clifford Hurst BA FCA MCT**
Finance Director and Company Secretary, age 45

Joined Zotefoams plc in October 2000 from Thermos Limited where he was Commercial Director and prior to that Finance Director. Previously with Caradon plc, ICI plc and Ernst & Young.

He is non-executive Chair of Harrow College of Further Education.

**4. Richard Clowes BSC, C.ENG, M.I.MECH.E *†#**
Non-executive Director, age 57

Appointed to the Board in July 2007. Previously worked for GKN plc and before that TI Group plc. He has wide operations and general management experience at both companies and whilst at GKN he was a Divisional Managing Director for their Powder Metallurgy, Offhighway and Autocomponents Divisions. He was a main Board Director of GKN plc for 2001 to 2005.

**5. Roger Lawson FCA*†#**
Senior independent non-executive Director and Chairman of the Audit Committee, age 62

Appointed to the Board in December 2002. Previously a Director of 3i plc and a former President of the Institute of Chartered Accountants in England and Wales.

He is a non-executive Director of a number of unlisted Companies and a Trustee of the Thalidomide Trust.

**6. David Campell BA FCIPD*†#**
Non-executive Director and Chairman of the Remuneration Committee, age 57

Appointed to the Board in February 2007. Previously Chief Executive of British Vita plc where he worked for over 30 years.

He is a non-executive Director of Fenner plc.

* Member of the Remuneration Committee
† Member of the Audit Committee
# Member of the Nominations Committee

**Registered Office**
675 Mitcham Road
Croydon CR9 3AL

**Registered Number**
2714645

**Financial Advisers**
Hawkpoint Partners Limited
41 Lothbury
London EC2R 7AE

**Auditors**
KPMG Audit Plc
1 Forest Gate
Brighton Road
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**Corporate Brokers**
Evolution Securities Ltd
100 Wood Street
London EC2V 7AN

# Directors' Report

The Directors present their annual report and audited financial statements for the year ended 31 December 2007.

### Principal activity

The Group's principal activity is the manufacture and distribution of cross-linked block foams.

### Business review

The Company is required by the Companies Act to set out in this report a fair review of the business of the Group during the financial year ended 31 December 2007 and of the position of the Group at the end of the year and a description of the principal risks and uncertainties facing the Group. The information that fulfils this requirement can be found within the Business Review on pages 12 to 17.

### Results and dividends

Profit attributable to shareholders for the year amounted to £2.92m (2006: £1.24m). An interim dividend of 1.5p (2006: 1.5p) per share was paid on 27 September 2007. The Directors recommend that a final dividend of 3.0p (2006: 3.0p) per share be paid on 22 May 2008 to shareholders who are on the Company's register at the close of business on 25 April 2008. This amounts to a total dividend of 4.5p per share for the year (2006: 4.5p).

### Directors

All of the current Directors named on page 19 to served throughout the year apart from D A Campbell who joined the Board on 22 February 2007 and R J Clowes who joined the Board on 23 July 2007. In addition C J Ryan was a Director until 31 December 2007.

The Director retiring by rotation at the Annual General Meeting ('AGM') is R H Lawson who, being eligible, offers himself for re-election. R H Lawson has a service contract which is terminable on six months' written notice. R J Clowes, who was appointed a Director after the last AGM, being eligible, also offers himself for re-appointment at the AGM. Biographical details of R H Lawson and R J Clowes can be found in the section on Directors and Advisers on pages 19.

The Company has granted indemnities in favour of Directors under Deeds of Indemnity. The Deeds came into force from February 2007 and remain in force as at the date of this report. The Deeds and the Company's Articles of Association are available for inspection during normal business hours at the Company's registered office and will be available at the AGM.

### Employees

To ensure employee welfare, the Group has documented and well-publicised policies on occupational health and safety, the environment and training. It operates an equal opportunities, single status employment policy, together with an open management style. The Company operates to a number of recognised industry standards including Quality (ISO 9001), Environmental (ISO 14001) and Occupational Health and Safety (OHSAS 18001) approvals. Further details of the Group's employment policies, including its policy regarding the employment of disabled people are set out in the Corporate and Social Responsibility Report on page 28.

### Substantial shareholdings

As at 3 March 2008, the Company had received notice of the following material interests of 3% or more in the issued ordinary share capital:

| | Ordinary share of 5.0p | Percentage of issued share capital |
|---|---|---|
| Schroder Investment Management | 4,417,325 | 11.98% |
| Liontrust Asset Management Ltd | 3,607,142 | 9.79% |
| Alveo AG (a subsidiary of Sekisui Chemical Co Ltd) | 3,465,762 | 9.40% |
| DWS Investment GmbH | 2,930,777 | 7.95% |
| Gartmore Investment Limited | 2,893,433 | 7.85% |
| Aberdeen Asset Management PLC's Fund Management Subsidiaries | 2,357,100 | 6.39% |
| Third Advance Value Realisation Company Limited | 1,754,192 | 4.76% |

The holding held by Schroder Investment Management includes beneficial and non-beneficial interests. The non-beneficial interests include holdings held on behalf of the Mineworkers Pension Scheme (2,625,000 shares, 7.12%) and British Coal Staff Superannuation Scheme (2,041,612 shares, 5.54%). Directors' shareholdings are shown in the Directors' Remuneration Report.

### Research and development

The amount spent by the Group on R&D in the year was £803,000 (2006: £924,000). This included work on PVDF and nylon as well as potential longer-term products in the development pipeline. In the opinion of the Directors none of this expenditure met the requirements for capitalisation in IAS 38 and it was consequently expensed in the Consolidated Income Statement.

### Creditor payment policy

It is not Group policy to follow any standard or code of payment practice. Payment terms are agreed with suppliers when negotiating contracts or transactions. The Group aims to ensure that subject to any necessary variations which may result from supplier-related problems, the agreed payment terms are adhered to. At 31 December 2007, trade creditors of the Company represented 17 days of purchases (2006: 29 days).

### Share capital and reserves

There were 279,014 shares issued following the excercise of share options during the year. Movements in reserves are shown in note 19 to the financial statements.

At the AGM held on 10 May 2007 the Company was given authority to purchase up to 3,631,992 of its ordinary shares. This authority will expire at the 2008 AGM. During the period from 10 May 2007 until the date of this Report 196,330 shares were purchased by the Company and cancelled, and a special resolution will be proposed at this year's AGM to renew the authority to make market purchases up to a maximum of 10% of the issued share capital of the Company.

**Treasury and financial instruments**
Information in respect of the Group's policies on financial risk management objectives, including policies for hedging, as well as an indication of exposure to financial risk is given on pages 16 and 17 and in note 20 to the financial statements.

**Pension scheme**
Zotefoams plc closed its Defined Benefit Pension Scheme to future accrual of benefit in December 2005. Employees are offered membership of a Defined Contribution Pension Scheme.

**Charitable and political donations**
The Group made no charitable contributions (2006: $570) and no political contributions (2006: nil) in the year.

**Disclosure of information to auditors**
The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

**Auditors**
A resolution to re-appoint KPMG Audit Plc as the Company's auditor will be proposed at the forthcoming AGM.

By order of the Board

**C G Hurst**
Company Secretary
3 March 2008

# Directors’ Remuneration Report

This report has been prepared in accordance with Schedule 7A of the Companies Act 1985. The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the principles relating to Directors’ remuneration. As required by the Act, a resolution to approve this report will be proposed at the AGM of the Company at which the approval of the financial statements will be proposed.

The Act requires the auditor to report to the Company’s members on certain parts of the Directors’ Remuneration Report and to state whether in their opinion those parts of the report have been properly prepared in accordance with the Companies Act 1985. The report has therefore been divided into separate sections for audited and unaudited information.

## Information not subject to audit

**Remuneration Committee**

The Company has established a Remuneration Committee which is constituted in accordance with the recommendations of the Combined Code. N G Howard and R H Lawson were members of this Committee throughout 2007 to the date of this report. C J Ryan was a member of the Committee from1 January 2007 to 31 December 2007. D A Campbell and R J Clowes have been members of the Committee from 22 February 2007 and 23 July 2007 respectively to the date of this report. All the members are independent non-executive Directors apart from N G Howard, who was independent on appointment as Chairman of the Company on 1 January 2007. The Committee was chaired in 2007 by C J Ryan from 1 January 2007 to 11 July 2007 and then by D A Campbell from 12 July 2007 to the date of this report.

None of the Committee has any personal financial interest (other than as shareholders), conflicts of interest from cross-directorships or day-to-day involvement in running the business. The Committee makes recommendations to the Board. No Director plays a part in any decision about his own remuneration.

In determining aspects of the Directors’ remuneration for the year, the Committee consulted D B Stirling (Managing Director) about its proposals. The Committee also appointed MM&K Limited, who are remuneration consultants, to provide advice on structuring Directors’ remuneration packages. MM&K Limited did not provide any other services to the Company or Group.

**Remuneration policy for the executive Directors**

Executive remuneration packages are prudently designed to attract, motivate and retain Directors of the high calibre needed to maintain the Group’s position as a market leader and to reward them for enhancing value to shareholders.

The performance measurement of the executive Directors and key members of senior management and the determination of their annual remuneration package are undertaken by the Committee.

There are five main elements of the remuneration package for executive Directors and senior management:

- basic annual salary;
- benefits;
- annual bonus plan;
- long-term incentive schemes; and
- pension arrangements.

The Committee’s policy is that a substantial proportion of the remuneration of the executive Directors should be performance related. As described below, executive Directors may earn annual incentive payments which are capped as a percentage of basic salary together with the benefits of participation in long-term incentive arrangements.

**Basic annual salary**

An executive Director’s basic annual salary is reviewed by the Committee at the beginning of each year and when an individual changes position or responsibility. In deciding appropriate levels the Committee considers the Executive Team as a whole, individual performance and independent surveys of Directors’ remuneration. The Committee’s policy is to set basic annual salaries at a level below what it believes is the average market rate for the individual concerned while setting the incentive potential at a consequently higher rate. Basic annual salaries were last increased on 1 April 2007.

The Company operates a salary sacrifice scheme under which employees can change their contract of employment with a consequent reduction in salary in exchange for an additional Company contribution to the employees’ pension scheme. In these cases bonuses and other incentive arrangements are calculated on salary prior to the reduction (bonusable salary). The reductions in salary made were 7% for C G Hurst and 7% for D B Stirling. Details of the contributions made by the Company into the Defined Contribution Pension Scheme for these individuals are shown in this report within the Information Subject to Audit.

**Benefits**

The executive Directors are entitled to receive certain benefits, principally a car allowance and private medical insurance.

**Annual bonus payments**

The Committee establishes the objectives that must be met for each financial year if a cash bonus is to be paid. In setting appropriate bonus levels the Committee refers to independent surveys of Directors’ remuneration. The Committee believes that any incentive compensation awarded should be tied to the interests of the Company’s shareholders and that the principal measure of those interests is profit before taxation excluding exceptional items.

Executive Directors, other than the Managing Director, are also set personal objectives the non-achievement of which can restrict the bonus award made. The bonus award was capped at 100% of bonusable salary for 2007. Incentive payments under the scheme for the year ended 31 December 2007 varied between 49.6% and 47.1% of bonusable salary for the executive Directors. That element of the bonus payment over 40% of bonusable salary will be paid in restricted shares which will only be capable of release if the executive is still employed by the Company three years later. Profit before taxation, excluding exceptional items, increased by 26%.

The policy for 2008 and the future is for a maximum annual bonus of 100% of salary of which the Committee proposes any bonus payment over 40% of bonusable annual salary would be paid in restricted shares.

**Share options and Long-term incentives**
The Company currently does not operate any long-term incentive schemes other than the schemes described below.

The main long-term incentive scheme operated by the Company prior to 2007 was the Executive Share Option Scheme. The performance condition that the Committee has selected for this scheme was growth in normalised earnings per share excluding exceptional items. This performance condition, which applied to all executive Directors to whom options have been granted under the Scheme, was chosen because the Committee believed it best aligned this incentive with shareholder interests. The Company's policy was to phase the granting of share options by annual awards with an exercise value of up to a maximum of 1.5 times salary rather than to award them in a single large block to any individual. Options granted under the Scheme were normally exercisable no earlier than three years from the date of grant and no later than ten years from the date of the grant. The Scheme incorporates a clause so that it was agreed with the individual, before they were granted an option, that the Company will transfer its National Insurance Contributions (NICs) liability to the individual, or it will recover any NICs paid in this regard upon the exercise of an option from the individual. No awards have been made under this scheme in 2007.

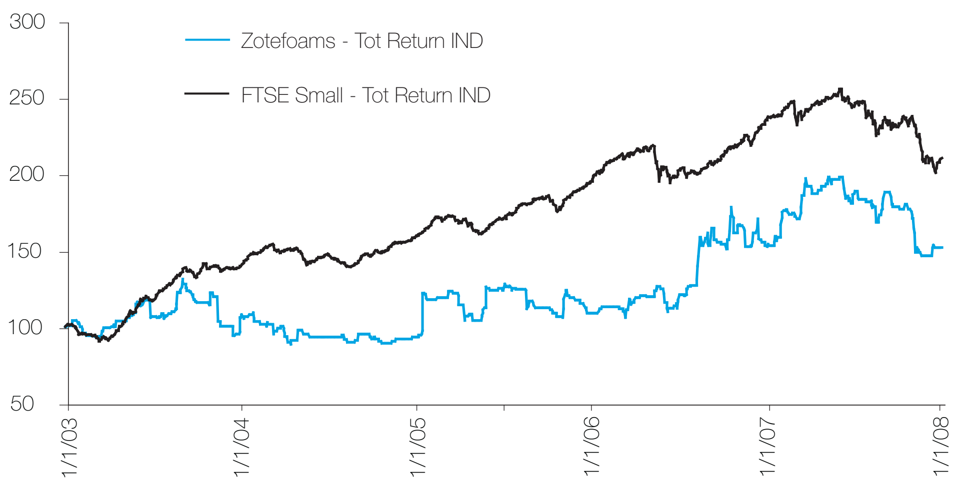
UK based executive Directors and senior management have been granted share options under a Her Majesty's Revenue and Customs Approved Share Option Scheme. These options are not exercisable unless the Group's normalised earnings per share, excluding exceptional items, increases by at least six percentage points in excess of the increase in the Retail Price Index over the same period. The scheme has now expired and the Board will propose a resolution to open a new HMRC SOS at the 2008 AGM.

The exercise price of the options granted under the above schemes is equal to the market value of the Company's share price at the time when the options are granted. The executive Directors are entitled to participate provided they meet the eligibility requirements of the schemes.

Following shareholder approval at the 2007 AGM the Company made a Long-Term Incentive Plan (LTIP) award to the executive Directors and senior management. Normally an annual award of 50% of salary would apply to Directors. However, as stated in the circular letter to shareholders that accompanied the 2007 AGM notice an award of 100% of salary was made in 2007 to compensate for the lack of a long-term incentive award in 2006. The LTIP awards are subject to performance conditions on Total Shareholder Return and EPS (excluding exceptional items) over a three year period.

**Pension arrangements**
The executive Directors are members of the Zotefoams Defined Contribution Alternative Pension Plan. Prior to 31 December 2005 the executive Directors were active members of the Zotefoams Defined Benefit Pension Scheme (the "Scheme"). However, this Scheme closed to future accrual of benefit on 31 December 2005 and after this date the executive Directors became deferred members of this Scheme.

**Performance Graph**
The following graph charts the total cumulative shareholder return (share price movements plus dividends reinvested) of the Company since January 2003. It is compared to the FTSE Small Cap Index which the Board believes is the most relevant comparison for a company of Zotefoams' size. Zotefoams and FTSE Small Cap Total Return Index ("TRI") re-based to 100 (January 2003 to December 2007).




**Service contracts**
The executive Directors have service contracts with the Company which are terminable on twelve months' written notice from the Company or the respective Director.

The non-executive Directors and the Chairman have three year contracts which can be terminated by the Director or the Company on six months' written notice.

The service agreements between each of the Directors and the Company do not entitle the respective Director to payment of compensation on termination other than statutory compensation.

**Non-executive Directors**
All independent non-executive Directors and the Chairman have specific terms of engagement and their remuneration is determined by the Board within the limits set by the Articles of Association and based on independent surveys of fees paid to non-executive Directors of similar companies. Independent non-executive Directors and the Chairman cannot participate in any of the Company's share options schemes and are not eligible to join the Company's pension scheme.

# Directors' Remuneration Report continued

## Information subject to audit

### Directors' emoluments

| Remuneration in £ | Basic salary/fees | Operational bonus | Car allowance | Company pension contributions(2) | Other benefits(1) | **Total 2007** | Total 2006 |
|---|---|---|---|---|---|---|---|
| D Campbell | 20,170 | — | — | — | — | **20,170** | — |
| R J Clowes | 9,647 | — | — | — | — | **9,647** | — |
| A Eldrett(4) | — | — | — | — | — | **—** | 32,584 |
| W H Fairservice(3) | — | — | — | — | — | **—** | 56,965 |
| N G Howard | 45,000 | — | — | — | — | **45,000** | 23,000 |
| C G Hurst | 93,604 | 48,062 | 10,561 | 17,868 | 1,201 | **171,296** | 142,772 |
| R H Lawson | 23,563 | — | — | — | — | **23,563** | 23,000 |
| C J Ryan | 23,000 | — | — | — | — | **23,000** | 21,000 |
| D B Stirling | 130,961 | 72,416 | 11,640 | 20,514 | 2,339 | **237,870** | 191,578 |
| | 345,945 | 120,478 | 22,201 | 38,382 | 3,540 | **530,546** | 490,899 |

**Note:**
1) Other benefits are calculated in terms of taxable values in the UK. In 2007 D B Stirling opted to change his contract of employment under a salary sacrifice arrangement, through which his salary is reduced and he received childcare benefits of £1,215.
2) The Company operates a Defined Contribution ("DC") Pension Plan. Individuals can opt to change their contract of employment under a salary sacrifice arrangement, under which their salary is reduced and the Company makes a corresponding contribution into their DC Pension Plan. Both the executive Directors have opted for the salary sacrifice scheme and the total contributions made by the Company to each individual's pension plan are shown above. None of the executive Directors made any employee contributions to the DC Pension Plan.
3) W H Fairservice retired from the Board on 31 December 2006. He continued to receive a salary and private medical insurance until 30 June 2007 in order to provide support during the handover of the Chairmanship to N G Howard. This amounted to £29,105.
4) A Eldrett retired from the board on 31 March 2006. In 2007, received £47,724 as salary, an operational bonus of £22,940, Company pension contributions of £11,670 and other benefits of £2,113. In 2006 following his resignation from the Board he received £68,078 as salary, an operational bonus of £30,609, Company pension contributions of £16,729 and other benefits of £1,574.

### Directors' shareholdings

The beneficial and non-beneficial interests of the Directors (including persons connected with them within the meaning of Section 346 of the Companies Act 1985) in the ordinary shares of the Company are set out below:

| Number of ordinary 5p shares | **31 December 2007** | 31 December 2006 |
|---|---|---|
| D A Campbell (appointed 22 February 2007) | **5,939** | — |
| R J Clowes (appointed 23 July 2007) | **20,000** | — |
| N G Howard | **40,000** | 20,000 |
| C G Hurst | **78,745** | 37,366 |
| R H Lawson | **5,000** | 5,000 |
| C J Ryan (resigned 31 December 2007) | **20,000** | 20,000 |
| D B Stirling | **66,979** | 40,962 |
| | **236,663** | 123,328 |

There have been no changes to Directors' interests between the end of the financial year and the date of this report.

### Share options

Options over ordinary shares granted:

| | Scheme | As at 31 December 2006 | Granted | Exercised | Lapsed | Cancelled | **As as 31 December 2007** | Exercise price | Exercisable | Expiry date |
|---|---|---|---|---|---|---|---|---|---|---|
| C G Hurst | HMRC SOS | 41,379 | — | 41,379 | — | — | **—** | 72.5p | 7.4.2007 | 6.4.2014 |
| C G Hurst | Executive SOS | 178,895 | — | — | 119,264 | — | **59,631** | 72.5p | 7.4.2007 | 6.4.2014 |
| D B Stirling | Executive SOS | 246,280 | — | 82,093 | 164,187 | — | **—** | 72.5p | 7.4.2007 | 6.4.2014 |
| C G Hurst | Executive SOS | 173,863 | — | — | — | — | **173,863** | 77.0p | 22.12.2008 | 21.12.2015 |
| D B Stirling | Executive SOS | 240,584 | — | — | — | — | **240,584** | 77.0p | 22.12.2008 | 21.12.2015 |
| D B Stirling | HMRC SOS | 37,267 | — | — | — | 37,267 | **—** | 80.5p | 27.3.2009 | 26.3.2016 |
| C G Hurst | HMRC SOS | — | 23,529 | — | — | 23,529 | **—** | 127.5p | 10.5.2010 | 9.5.2017 |
| C G Hurst | LTIP | — | 80,000 | — | — | — | **80,000** | nil | 10.5.2010 | n/a |
| D B Stirling | LTIP | — | 114,509 | — | — | — | **114,509** | nil | 10.5.2010 | n/a |

### HMRC Approved Share Option Scheme (HMRC SOS)

These options have been granted under a HMRC Approved Share Option Scheme. These options are not exercisable unless the Group's normalised earnings per share (EPS), before exceptional items, increases over a three year period by at least six percentage points in excess of the increase in the Retail Price Index over the same period. The option award to C G Hurst issued on 7 April 2004 for 41,379 shares vested in full because the increase in EPS from 2003 to 2006 was over 6% above rpi. The option awards made on 27 March 2006 and 10 May 2008 were cancelled because it was subsequently found the scheme had expired in 2005 and awards should not have been made after this date. The Board will propose a resolution to open a new HMRC SOS at the 2008 AGM.

**Executive Share Option Scheme (Executive SOS)**
These options have been granted under the Zotefoams Executive Share Option Scheme. These options are not exercisable unless the normalised Group earnings per share, before exceptional items, increase by a percentage in excess of the increase in the Retail Price Index over a three year period. Further conditions control the amount of shares available under these options. The option awards are reduced by one-third or two-thirds if certain thresholds are not reached.

The thresholds are as follows:

| | Percentage increase above RPI needed for: | | |
|---|---|---|---|
| Executive share options first exercisable in: | Full award | Two-third award | One-third award |
| 2008 | 200% | 150% | 100% |

So, for example, if the Retail Price Index increased by 9% from 2004 to 2007 a 209% increase in earnings per share over the three year period 2004 to 2007 would be required for the options exercisable in 2008 to become capable of being exercised in full.

The Executive SOS options awarded in 2004, which were first exercisable in April 2007 vested with one-third of the options awarded.

The Executive SOS options awarded in 2005, which are exercisable in December 2008 will vest, provided the service conditions are satisfied, with two-thirds of the options awarded.

There were no options awarded under the Executive SOS in 2007 and there have been no changes in options granted between the end of the year and the date of this report.

The middle market quoted share price at 31 December 2007 was 96.5p and the high and low prices during the year were 130.0p and 93.0p respectively.

**Long-term Incentive Plans (LTIP)**
The LTIP awards made in 2007 are subject to performance and service conditions. 50% of the award is subject to growth in Total Shareholder Return (TSR) and 50% subject to EPS growth. Performance is measured over a three year period and the proportion of restricted shares will be released to the participant, to the extent to which TSR and EPS targets over the period have been met.

These criteria are:

| | Threshold | | Maximum | |
|---|---|---|---|---|
| | **Performance Target** | **% of award vesting** | **Performance Target** | **% of award vesting** |
| TSR goal | 10% pa growth | 12.5 | 25% pa growth | 50 |
| EPS goal | 7.4p | 12.5 | 10.4p | 50 |

The total award vesting is the sum of the Awards for TSR and EPS. If the performance is below the EPS threshold then no part of the EPS award vests. If performance is below the TSR threshold then no part of the TRS award vests. Between the threshold and the maximum, the award vests on a sliding scale basis.

The market value of the LTIP shares granted was 127.5p on the date of the grant.

# Directors' Remuneration Report continued

**Directors' pension entitlements**

The executive Directors are members of the Zotefoams Defined Contribution Alternative Pension Plan. Under a salary sacrifice agreement all contributions to this pension plan are paid by the Company and the contributions made by the Company in 2007 are shown in the table of Directors' Emoluments.

The following Directors are also deferred members of the Zotefoams Defined Benefit Pension Scheme and their benefits under this Scheme are shown below:

| | Accrued pension in scheme at year end(1) £ | Gross increase in pension £ | Increase in accrued pension net of inflation £ | Value of accrued pension at year end(2) £ | Value of accrued pension at start of year £ | Total change in value over period less Directors contributions(3) £ |
|---|---|---|---|---|---|---|
| C G Hurst | 7,873 | 274 | — | 58,758 | 54,827 | 3,931 |
| D B Stirling | 15,469 | 538 | — | 100,919 | 94,341 | 6,578 |

**Notes**

1) The pension entitlement shown is that which would be paid annually on retirement at normal retirement age (or immediately upon late retirement where applicable), based on service to 31 December 2005 (the date the scheme was closed to future accrual) and excluding any future increases under the Rules of the Scheme.
2) Transfer values have been calculated in accordance with version 9.3 of guidance note GN11 issued by the Board of Actuarial Standards, on the basis agreed with the Trustees of the Scheme.
3) The change in the transfer value over the year includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as changes in financial conditions.

The following is additional information relating to Directors' pensions from the Zotefoams Defined Benefit Pension Scheme:

a) Before the Scheme closed, members of the Scheme had the option of paying Additional Voluntary Contributions (AVCs). The value of these AVCs has been excluded from the above figures.
b) Normal retirement age is 65.
c) A Spouse's pension is payable on death in service equal to one-third of the member's annual salary at death.
On death after leaving service and before retirement, a spouse's pension is payable of one-half of the member's preserved pension at leaving, revalued from leaving date to the date of death, in line with statutory revaluation increases.
On death in retirement, a spouse's pension is payable of one-half of the member's pension at death, without reduction for any part of the member's pension surrendered for cash at retirement.
d) Members' Guaranteed Minimum Pensions increase at statutory rates. Other pensions increase at 5% per annum or the increase in the Retail Price Index if less.

**Approval**

The report was approved by the Board of Directors on 3 March 2008 and signed on its behalf by:

**D A Campbell**

Non-executive Director and Chairman of the Remuneration Committee

3 March 2008

# Audit Committee Report

**Summary of the role of the Audit Committee**
The Audit Committee is appointed by the Board and includes the independent non-executive Directors of the Company. The Audit Committee's terms of reference include all matters indicated by the Combined Code. The terms of reference are considered annually by the Audit Committee and are then referred to the Board for approval.

The Audit Committee is responsible for:
- monitoring the integrity of the financial statements of the Group and any formal announcements relating to the Group's financial performance and reviewing significant financial reporting judgements contained therein;
- reviewing the external auditor's management letter and management responses;
- reviewing the Group's internal controls and risk management systems;
- reviewing the arrangements by which staff may, in confidence, raise concerns about possible improprieties ('the whistleblowing policy');
- assessing the need for an internal audit function;
- making recommendations to the Board, for a resolution to be put to the shareholders for their approval in general meeting, in relation to the appointment of the external auditor and the approval of the remuneration and terms of engagement of the external auditor;
- reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements; and
- developing and implementing a policy on the engagement of the external auditor to supply non-audit services, taking into account relevant guidance regarding the provision of non-audit services by the external audit firm.

The Audit Committee is required to report its findings to the Board, identifying any matters in respect of which it considers that action or improvement is needed, and make recommendations as to the steps to be taken.

**Composition of the Audit Committee**
The members of the Audit Committee in 2007 were the independent non-executive Directors of the Company R H Lawson, D A Campbell, C J Ryan and R J Clowes. C J Ryan retired from the Committee on 31 December 2007. D A Campbell and R J Clowes joined the Committee on 22 February 2007 and 23 July 2007 respectively. R H Lawson is Chairman of the Committee and is a Fellow of the Institute of Chartered Accountants in England and Wales.

The Committee normally comprises three members, with a minimum of two members at any time. Two members constitute a quorum.

The Audit Committee structure requires the inclusion of one financially qualified member with relevant financial experience. Currently the Audit Committee Chairman fulfils this requirement. All Audit Committee members are expected to be financially literate. The Company provides training if required.

**Meetings**
The Audit Committee is required to meet at least twice per year and has an agenda linked to events in the Company's financial calendar. The agenda is predominantly based around these events and is therefore approved by the Audit Committee Chairman on behalf of his fellow members. Each Audit Committee member has the right to require reports on matters of interest in addition to standard agenda items.

The Audit Committee invites the Company Chairman, Managing Director, Finance Director, Financial Controller and senior representatives of the external auditor to attend relevant meetings, although it reserves the right to request any of these individuals to withdraw. For part of a meeting each year it meets with senior representatives of the external auditor without anyone else being present. Other senior management may be invited to present such reports as are required for the Committee to discharge its duties.

**Overview of the actions taken by the Audit Committee to discharge its duties**
Since the beginning of 2007 the Audit Committee has:
- reviewed the financial statements in the 2006 and 2007 report and accounts and the interim report issued in August 2007. As part of this review the Committee received reports from the external auditor on the audit of the annual reports and accounts and the review of the interim report;
- considered the output from the Group-wide process used to identify, evaluate and mitigate high level business risks;
- reviewed the effectiveness of the Group's internal controls (including, but not limited to, financial controls) and disclosures made in the annual report on this matter;
- reviewed and agreed the scope of the audit work to be undertaken by the external auditor;
- considered the views of the external auditor on the effectiveness of the Group's internal financial controls;
- agreed the fees to be paid to the external auditor for their audit and work on the accounts and interim report;
- reviewed its own effectiveness;
- undertaken an assessment of the need for an internal audit function; and
- undertaken an evaluation of the independence and effectiveness of the external auditor.

**External auditor**
The Audit Committee is responsible for the development, implementation and monitoring of the Group's policy on external audit. Although the external auditor is allowed to provide non-audit services the Committee monitors the extent of these services to ensure that they do not compromise the auditor's objectivity. It also assesses the effectiveness of the external auditor in relation to their fulfilment of the agreed audit plan, the robustness and perceptiveness of the auditor in handling key accounting and audit judgements and the thoroughness of the auditor's review of internal financial controls. As a consequence of its satisfaction with the results of these activities the Audit Committee has recommended to the Board that the external auditor should be re-appointed.

**Internal audit function**
The Audit Committee has reviewed the need for an internal audit function and concluded that given the size of the Group and the proximity of the executive Board members to Group operations an internal audit function covering financial controls is not considered necessary at this time. However, an internal audit function does exist to ensure compliance with procedures for environmental, quality and health and safety procedures. The Audit Committee also maintains an oversight over the Company's whistleblowing policy.

**Overview**
As a result of its work during the year, the Audit Committee has concluded that it has acted in accordance with its terms of reference and has ensured the independence and objectivity of the external auditor. The Chairman of the Audit Committee will be available at the AGM to answer any questions about the work of the Committee.

**Approval**
This report was approved by the Audit Committee and signed on its behalf by:

**R H Lawson**
Non-executive Director and Chairman of the Audit Committee
3 March 2008

# Corporate and Social Responsibility Report

Zotefoams considers that the management of safety, health, environmental, social and ethical matters forms a key element of effective corporate governance. These areas are covered by the internal control systems and procedures outlined in the Corporate Governance Report on page 29.

**Safety, Health and Environment (SHE)**
The Board has separate policies in place relating to Health, Safety and Environment. In line with best practice, the Company is certified to accredited standards OHSAS 18001 on Health and Safety and ISO 14001 the International Standard for Environmental Management Systems.

The Board has ultimate responsibility for SHE policy and performance and receives reports on SHE issues on a quarterly basis. Annual performance objectives are agreed by the Board and performance against these objectives is monitored as part of our quarterly reporting programme.

In 2007 the Finance Director was directly responsible to the Board for Health, Safety and Environmental performance. Site committees meet quarterly to consider all SHE matters and Steering Committees, chaired by the Managing Director (or appropriate responsible person in subsidiary companies), also meet quarterly to consider overall performance and the impact of current and impending legislation. A Health and Safety Adviser and an Environmental Adviser support these groups.

Senior managers are responsible for ensuring that SHE policies are implemented in their departments, all employees are informed of the departmental requirements and departmental training on environmental issues and safe working practices is up to date. Regular audits are conducted to ensure policy and procedure implementation is appropriate. All employees are made aware that primary responsibility for safety lies with the employee.

We take reporting of all incidents very seriously, including "near misses" and plant or equipment damage not resulting in personal injury. All events are investigated by appropriate levels of management to establish root cause and to eliminate re-occurrence wherever possible.

**Health and safety performance**
The operational environment at Zotefoams contains few controlled substances and our manufacturing plant involves mainly manual handling and materials processing. The risks to our process are assessed whenever new or altered equipment or materials are introduced and at regular periods thereafter. The most strictly controlled parts of our sites are where pressure is used.

Operating vessels at high-pressures, Zotefoams is subject to the Pressure Systems Safety Regulations 2000 in the UK and OSHA in the US. Tightly defined procedures and operational controls are in place to manage the safety of our pressure systems. Fail-safe mechanisms known as Pressure Relief Valves (PRV's) and bursting disks (which are the equivalent of fuses in an electrical system) are designed and installed into our pressure systems. Failure of a PRV or bursting disk leads to depressurisation of sections of our system releasing nitrogen gas into the atmosphere and mitigating any further risks.

In 2005 unanticipated corrosion caused by the water-cooling mechanism which Zotefoams uses for some of its high-pressure vessels was found. This was reported in the 2005 annual report. To minimise the extent of this corrosion the Board has accelerated the refurbishment and upgrade programme for the vessels involved. Our target, which is based on the most prudent course from a safety perspective while continuing to operate, is for a serial refurbishment of all water-cooled vessels on the shortest practical timescale. To date we have completed the refurbishment of three vessels under this programme. Three further vessels are affected and these are being monitored prior to refurbishment or withdrawal from service.

In 2007 there were 7 reportable lost time injuries in the Group (2006: 1). Four of these were strain injuries and three were impact injuries (one fracture and two cuts). All had different causes and have been fully investigated with corrective actions implemented. Additional training programmes have been held in 2007 for safety representatives and in 2008 will be held for all managers and supervisors in Zotefoams plc.

**Environmental performance**
The Board considers the processes used by Zotefoams to be among the most, if not the most, environmentally friendly way to manufacture polymer foams. Our process uses pure nitrogen gas to expand the foams. The common peroxide cross-linking agent, which enhances foam properties, is completely utilised during processing and, importantly, no other chemical additives are present in our basic foam products. The result is that our basic foam products have no toxic or volatile chemicals (such as solid chemical residues, CFC, HCFC or volatile hydrocarbons) remaining in the material structure. Such substances are present in competitive products.

During 2007 the Group had 13 internally recorded environmental incidents (2006: 12). The most frequently recorded incident remained the releases of nitrogen gas into the air from bursting disks which are an essential part of our statutory equipment safety regime (2007:9, 2006: 9). While Zotefoams record this as an environmental incident principally on the grounds of utility loss and noise, we consider that the safety of our plant is of primary importance and regard these incidents as evidence that our safety processes are functioning as designed. There were two minor oil leaks both of which were cleaned up and disposed of in line with environmental regulations. Two noise complaints were received and actions were taken to prevent their re-occurance in the future.

The vast majority of all waste produced by Zotefoams plc is either solid or foamed polyolefin. Neither are easily melt-processed (the major recycling route for most plastics) due to our essential step of cross-linking our polymers during manufacture. In 2007 only 7% of the total foam waste produced was sent to landfill (2006: 7%) and the rest was successfully recycled.

Energy consumption per unit of foam manufactured is monitored and reviewed regularly during the year. There are continuing efforts across the site to improve energy efficiency. Zotefoams is negotiating via a third party to join a group of companies in a Climate Change Levy (CCL) agreement. This will involve agreeing specific targets to reduce energy consumption.

**Employees**
Zotefoams regards its workforce as a key part of the business. It operates an equal opportunities policy and believes that a wide array of diversity (in ethnicity, age, gender, language, sexual orientation, religion, socio-economic status or even personality and ability) promotes innovation and business success. Applications for employment by disabled persons are always fully considered. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Zotefoams places considerable value on the involvement of its employees and continues to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Group. Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests.

**Business ethics**
Zotefoams is committed to high standards of business conduct and seeks to maintain these standards across all of its operations throughout the world. The Group has adopted a Code of Business Conduct, approved by the main Board, which provides practical guidance for all staff. This guidance is included in the employee handbook and incorporated into an induction process which all employees must complete.

# Corporate Governance

The Company is committed to the principles of corporate governance contained in the Combined Code on Corporate Governance (the 'Code') that was issued in 2006 by the Financial Reporting Council for which the Board is accountable to shareholders.

**Statement of compliance with the Combined Code**
Throughout the year ended 31 December 2007 the Company has been in compliance with the Code provisions set out in Section 1 of the Code.

**Statement about applying the principles of the Code**
The Company has applied the principles set out in Section 1 of the Code, including both the main principles and the supporting principles, by complying with the Code as reported above. Further explanation of how the principles and supporting principles have been applied is set out below and in the Directors' Remuneration Report and the Audit Committee Report.

**Board effectiveness**
The Board's role is to provide the entrepreneurial leadership of the Company within a framework of prudent and effective controls which enable risk to be assessed and managed. The Board sets the strategic aims of the Company, ensures that the necessary resources are in place to achieve the Company's objectives and reviews management performance. The Board's role is to act as representative of the shareholders, who are the Company's owners and focuses on the governance of the Company. Management is delegated to the executive Directors and the senior executive management of the Group. All Directors must take decisions objectively in the interests of the Company.

As part of their role as members of a unitary Board, non-executive Directors constructively challenge and help develop proposals on strategy. Non-executive Directors scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive Directors and have a prime role in appointing, and where necessary removing, executive Directors, and in succession planning.

The Board has three major committees which report into it and function within defined terms of reference. These are the Audit Committee, the Remuneration Committee and the Nominations Committee. The terms of reference for these Committees are available on the Company's website www.zotefoams.com and in paper form, on request from the Registered Office of the Company.

Attendance details for 2007 by the Directors for meetings of the Board and these Committees are shown below:

| | Full Board meetings | | Audit Committee meetings | | Remuneration Committee meetings | | Nominations Committee meetings | |
|---|---|---|---|---|---|---|---|---|
| Attendance at meetings | Eligible | Attended | Eligible | Attended | Eligible | Attended | Eligible | Attended |
| D A Campbell | 7 | 7 | 3 | 3 | 3 | 3 | 3 | 3 |
| R J Clowes | 4 | 4 | 2 | 2 | 1 | 1 | 1 | 1 |
| N G Howard | 8 | 8 | n/a | n/a | 4 | 4 | 4 | 4 |
| C G Hurst | 8 | 8 | n/a | n/a | n/a | n/a | n/a | n/a |
| R H Lawson | 8 | 8 | 3 | 3 | 4 | 4 | 4 | 3 |
| C J Ryan | 8 | 5 | 3 | 2 | 4 | 2 | 4 | 3 |
| D B Stirling | 8 | 8 | n/a | n/a | n/a | n/a | n/a | n/a |

**Chairman and Managing Director**
The Chairman is responsible for leadership of the Board, ensuring its effectiveness on all aspects of its role and setting its agenda. The Chairman is also responsible for ensuring that the Directors receive accurate, timely and clear information. The Chairman facilitates the effective contribution of the non-executive Directors in particular and ensures constructive relations between executive and non-executive Directors.

The Managing Director is responsible for the running of the Company's business. He is supported by the other executive Director and senior management team members in the Group.

**Board balance and independence**
The Board structure usually comprises, in addition to executive Directors, three independent non-executive Directors and a non-executive Chairman. Following the resignation of W H Fairservice on 31 December 2006 and the appointment of N G Howard as Chairman, the Company had only two independent non-executive Directors until the appointment of D A Campbell on 22 February 2007. R J Clowes joined the Board as an independent non-executive Director on 23 July 2007 and C J Ryan retired from the Board on 31 December 2007 after completing eight years service as an independent non-executive Director. The Chairman, N G Howard, is also Chairman of the Nominations Committee and a member of the Remuneration Committee. N G Howard was independent on his appointment as Chairman.

No one other than the Committee Chairman and members is entitled to be present at a meeting of the Remuneration, Audit and Nominations Committees, but others may attend at the invitation of the Committees. During the year the Chairman met with the non-executive Directors without the executive Directors present and the non-executive Directors met without the Chairman being present.

# Corporate Governance continued

**Appointments to the Board**
Appointments to the Board are proposed by the Nominations Committee and approved by the Board. The Nominations Committee comprises the Chairman N G Howard (who is Chairman of the Nominations Committee) and the independent non-executive Directors. N G Howard was independent on his appointment as Chairman.

The Nominations Committee operates within a defined set of terms of reference from the Board and is responsible for managing the recruitment of new Board members within a specification set by the Board. Appointments to the Board are made on merit and against objective criteria. Care is taken to ensure that appointees have enough time to devote to the job.

Two new independent non-executive Directors were appointed in 2007, D A Campbell and R J Clowes. On both occasions the Nominations Committee used external search consultants, Hanson Green, to aid the selection process.

**Information and professional development**
Each month all Directors receive management reports and briefing papers in relation to Board matters. New appointments to the Board receive an induction and, if appropriate, training. Training is available subsequently in order to fulfil the requirements of being a Director of a listed company. All the Directors have access to the Company Secretary and independent professional advice at the Company's expense if required for the furtherance of their duties.

**Board evaluation**
A formal review of Board and Committee performance is carried out annually. The Chairman's performance is reviewed by the other non-executive Directors in consultation with the executive Directors. The other non-executive Directors' performance is evaluated by the Chairman in consultation with the executive Directors. Executive Directors' performance is evaluated by the Remuneration Committee in conjunction with the Managing Director (except in the case of the Managing Director, when the Managing Director is not present).

**Re-election**
Re-election of Board members is required at the first AGM following appointment and at least every three years thereafter. At the AGM in 2008 two Directors will stand for re-election:

- R H Lawson;
- R J Clowes, following his appointment in July 2007.

**Remuneration**
The principles and details of remuneration policy are set out in the Directors' Remuneration Report.

**Financial reporting**
The Directors' responsibilities for preparing the financial statements are set out in the Statement of Directors' Responsibilities.

**Audit Committee and auditors**
A separate Audit Committee Report provides details of the role and activities of the Committee and its relationship with the external auditor.

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

**Relations with shareholders**
The Company is always ready, where practicable, to enter into a dialogue with Shareholders to promote mutual understanding of objectives. Meetings with institutional shareholders are held twice a year following announcement of the Group's interim and final results. Other meetings may be held at institutional shareholder request. To ensure that the Board, particularly the non-executive Directors, understand the views of major shareholders, the Company's corporate brokers provided a summary of feedback from the meetings following the interim and final results announcements. The Chairman is available to meet institutional shareholders. The Senior Independent Director (R H Lawson) and other non-executive Directors will attend meetings with major shareholders if requested.

The Board considers the annual report and financial statements and AGM to be the primary vehicles for communication with private investors. The members of the Audit and Remuneration Committee will normally be present to speak at the AGM. The corporate website www.zotefoams.com contains information on the Company.

**Internal control**

The Board has applied principle C.2 of the Combined Code by establishing a continuous process for identifying, evaluating and managing the significant risks the Group faces. The Board regularly reviews the process, which has been in place from the start of the year to the date of approval of this report and which is in accordance with the revised guidance on internal control published in October 2005 (the Turnbull Guidance). The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

In compliance with provision C.2.1 of the Combined Code, the Board regularly reviews the effectiveness of the Group's system of internal control. The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management. It is based principally on reviewing reports from management to consider whether significant risks are identified, evaluated, managed and controlled and whether any significant weaknesses are promptly remedied and indicate a need for more extensive monitoring. The Board has also performed a specific assessment for the purpose of this annual report. This assessment considered all the significant aspects of internal control arising during the period covered by the report. The Audit Committee assists the Board in discharging its review responsibilities.

During the course of its review of the system of internal control, the Board had not identified nor been advised of any failings or weaknesses which it has determined to be significant. Therefore a confirmation in respect of necessary actions has not been considered appropriate.

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

**Control environment**

The Group has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Group objectives. Overall business objectives are set by the Board and communicated through the organisation. Lines of responsibility and delegations of authority are documented.

**Risk identification**

Group management are responsible for the identification and evaluation of key risks applicable to their areas of business. These risks are assessed on a continual basis and may be associated with a variety of internal or external sources including control breakdowns, disruption in information systems, competition, natural catastrophe and regulatory requirements.

**Information and communication**

Annual budgets are a key part of the planning process and performance against plan is actively monitored at Board level supported by quarterly forecasts. Statistics and commentary on actual operating performance are made available to all Directors monthly, and forecasts are presented to the Board quarterly.

Through these mechanisms, Group performance is continually monitored, risks identified in a timely manner, their financial implications assessed, control procedures re-evaluated and corrective actions agreed and implemented.

**Control procedures**

The Group has implemented control procedures designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to loss of assets or fraud. Measures taken include physical controls, segregation of duties, reviews by management, and external audit to the extent necessary to arrive at their audit opinion.

A process of control self-assessment and hierarchical reporting has been established which provides for a documented and auditable trail of accountability. These procedures are relevant across Group operations and provide for successive assurances to be given at increasingly higher levels of management and finally, to the Board. Planned corrective actions are independently monitored for timely completion.

**Monitoring and corrective action**

There are clear and consistent procedures in place for monitoring the system of internal financial and non-financial controls. The Audit Committee meets at least twice a year and, within its remit, reviews the effectiveness of the Group's system of internal financial controls. The Committee receives reports from external auditors and management.

Non-financial controls are reviewed regularly by executive management who report any issues and corrective actions taken directly to the Board.

# Statement of Directors' Responsibilities

**Statement of Directors' responsibilities in respect of the annual report and the financial statements**
The Directors are responsible for preparing the annual report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year.
Under that law they are required to prepare the Group financial statements in accordance with IFRS as adopted by the EU and have elected to prepare the Parent Company financial statements on the same basis.

The Group and Parent Company financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position of the Group and the Parent Company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.
In preparing each of the Group and Parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Independent Auditors' Report

To the members of Zotefoams plc

We have audited the Group and Parent Company financial statements (the "financial statements") of Zotefoams plc for the year ended 31 December 2007 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Recognised Income and Expenses, and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

**Respective responsibilities of directors and auditors**

The Directors' responsibilities for preparing the annual report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 32.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referenced from the Business Review section of the Directors' Report. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2006 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control 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 the other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent 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 International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

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

**Opinion**

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the Group's affairs as at 31 December 2007 and of its profit for the year then ended;
- the Parent Company financial statements give a true and fair view, in accordance with IFRS as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the Parent Company's affairs as at 31 December 2007;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

**KPMG Audit Plc**
Chartered Accountants
Registered Auditor
Crawley
3 March 2008

# Consolidated Income Statement

for the year ended 31 December 2007

| | Note | 2007 £000 | 2006 Pre-exceptional items £000 | 2006 Exceptional items (see note 4) £000 | 2006 Post-exceptional items £000 |
|---|---|---|---|---|---|
| **Revenue** | 2 | **31,606** | 30,052 | — | 30,052 |
| Cost of sales | | **(23,035)** | (22,257) | — | (22,257) |
| **Gross profit** | | **8,571** | 7,795 | — | 7,795 |
| Distribution costs | | **(2,344)** | (2,117) | — | (2,117) |
| Administrative expenses | | **(2,766)** | (2,842) | (1,074) | (3,916) |
| **Operating profit** | | **3,461** | 2,836 | (1,074) | 1,762 |
| Financial income | 6 | **1,063** | 884 | — | 884 |
| Finance costs | 6 | **(1,152)** | (1,047) | — | (1,047) |
| **Profit before tax** | | **3,372** | 2,673 | (1,074) | 1,599 |
| Taxation | 7 | **(454)** | (682) | 322 | (360) |
| **Profit for the year** | 3, 9 | **2,918** | 1,991 | (752) | 1,239 |
| Attributable to: | | | | | |
| Equity holders of the parent | | **2,918** | 1,991 | (752) | 1,239 |
| **Earnings per share** | | | | | |
| **Basic (p)** | 8 | **8.0** | | | 3.4 |
| **Diluted (p)** | 8 | **7.9** | | | 3.4 |

# Consolidated Statement of Recognised Income and Expense

For the year ended 31 December 2007

| | 2007 £000 | 2006 £000 |
|---|---|---|
| Foreign exchange translation differences on investment in foreign subsidiary | **(117)** | (905) |
| Effective portion of changes in fair value of cash flow hedges net of recycling | **(269)** | 163 |
| Actuarial gains on defined benefit schemes | **1,141** | 426 |
| Tax on items taken directly to equity | **(271)** | (159) |
| **Net income/(expense) recognised directly in equity** | **484** | (475) |
| Profit for the year | **2,918** | 1,239 |
| **Total recognised income and expense for the year** | **3,402** | 764 |
| Attributable to equity holders of the parent | **3,402** | 764 |

# Company Statement of Recognised Income and Expense

For the year ended 31 December 2007

| | 2007 £000 | 2006 £000 |
|---|---|---|
| Effective portion of changes in fair value of cash flow hedges net of recycling | **(269)** | 163 |
| Actuarial gains on defined benefit schemes | **1,141** | 426 |
| Tax on items taken directly to equity | **(271)** | (159) |
| **Net income recognised directly in equity** | **601** | 430 |
| Profit for the year | **2,733** | 571 |
| **Total recognised income and expense for the year** | **3,334** | 1,001 |
| Attributable to equity holders of the Company | **3,334** | 1,001 |

# Consolidated Balance Sheet

as at 31 December 2007

| | Note | 2007 £000 | 2006 £000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | **26,436** | 27,018 |
| Deferred tax assets | 17 | **138** | 99 |
| **Total non-current assets** | | **26,574** | 27,117 |
| **Current assets** | | | |
| Inventories | 12 | **4,280** | 3,785 |
| Trade and other receivables | 13 | **7,351** | 6,163 |
| Cash and cash equivalents | 14 | **258** | 82 |
| **Total current assets** | | **11,889** | 10,030 |
| **Total assets** | | **38,463** | 37,147 |
| **Equity** | | | |
| Issued share capital | 18 | **(1,820)** | (1,816) |
| Share premium | 19 | **(13,941)** | (13,753) |
| Capital redemption reserve | 19 | **(15)** | (5) |
| Translation reserve | 19 | **752** | 635 |
| Hedging reserve | 19 | **185** | (84) |
| Retained earnings | 19 | **(11,827)** | (9,815) |
| **Total equity attributable to the equity holders of the Company** | 19 | **(26,666)** | (24,838) |
| **Non-current liabilities** | | | |
| Interest-bearing loans and borrowings | 16 | **(300)** | (700) |
| Employee benefits | 22 | **(2,465)** | (4,240) |
| Deferred tax liabilities | 17 | **(2,699)** | (2,764) |
| **Total non-current liabilities** | | **(5,464)** | (7,704) |
| **Current liabilities** | | | |
| Interest-bearing loans and borrowings | 16 | **(400)** | (400) |
| Bank overdraft | 14 | **(1,242)** | (411) |
| Tax payable | | **(561)** | (307) |
| Trade and other payables | 15 | **(4,130)** | (3,487) |
| **Total current liabilities** | | **(6,333)** | (4,605) |
| **Total liabilities** | | **(11,797)** | (12,309) |
| **Total equity and liabilities** | | **(38,463)** | (37,147) |

These financial statements were approved by the Board of Directors on 3 March 2008 and signed on its behalf by:

**N G Howard**
Chairman

**C G Hurst**
Finance Director

# Company Balance Sheet

as at 31 December 2007

| | Note | **2007 £000** | 2006 £000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | **21,676** | 21,830 |
| Investment in subsidiaries | 11 | **5,649** | 5,678 |
| **Total non-current assets** | | **27,325** | 27,508 |
| **Current assets** | | | |
| Inventories | 12 | **3,355** | 3,155 |
| Trade and other receivables | 13 | **7,514** | 5,639 |
| Cash and cash equivalents | 14 | **—** | — |
| **Total current assets** | | **10,869** | 8,794 |
| **Total assets** | | **38,194** | 36,302 |
| **Equity** | | | |
| Issued share capital | 18 | **(1,820)** | (1,816) |
| Share premium | 19 | **(13,941)** | (13,753) |
| Capital redemption reserve | 19 | **(15)** | (5) |
| Hedging reserve | 19 | **185** | (84) |
| Retained earnings | 19 | **(10,335)** | (8,508) |
| **Total equity attributable to the equity holders of the Company** | 19 | **(25,926)** | (24,166) |
| **Non-current liabilities** | | | |
| Interest-bearing loans and borrowings | 16 | **(300)** | (700) |
| Employee benefits | 22 | **(2,465)** | (4,240) |
| Deferred tax liabilities | 17 | **(2,699)** | (2,764) |
| **Total non-current liabilities** | | **(5,464)** | (7,704) |
| **Current liabilities** | | | |
| Interest-bearing loans and borrowings | 16 | **(1,053)** | (400) |
| Bank overdraft | 14 | **(1,242)** | (411) |
| Tax payable | | **(561)** | (319) |
| Trade and other payables | 15 | **(3,948)** | (3,302) |
| **Total current liabilities** | | **(6,804)** | (4,432) |
| **Total liabilities** | | **(12,268)** | (12,136) |
| **Total equity and liabilities** | | **(38,194)** | (36,302) |

These financial statements were approved by the Board of Directors on 3 March 2008 and signed on its behalf by:

**N G Howard**
Chairman

**C G Hurst**
Finance Director

# Consolidated Cash Flow Statement

for the year ended 31 December 2007

| | Note | 2007 £000 | 2006 £000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit for the year | | **2,918** | 1,239 |
| Adjustments for: | | | |
| Depreciation, amortisation and impairment | | **3,129** | 3,251 |
| Gain on sale of plant and equipment | | **(9)** | — |
| Financial income | | **(1,063)** | (884) |
| Financial expense | | **1,152** | 1,047 |
| Equity-settled share-based payments | | **91** | 64 |
| Taxation | | **454** | 360 |
| **Operating profit before changes in working capital and provisions** | | **6,672** | 5,077 |
| Increase in trade and other receivables | | **(1,287)** | (107) |
| (Increase)/decrease in inventories | | **(504)** | 51 |
| Increase in trade and other payables | | **498** | 314 |
| Decrease in provisions and employee benefits | | **(600)** | (619) |
| **Cash generated from the operations** | | **4,779** | 4,716 |
| Interest paid | | **(138)** | (126) |
| Tax paid | | **(564)** | (823) |
| **Net cash from operating activities** | | **4,077** | 3,767 |
| Proceeds on disposal of property, plant and equipment | | **22** | 3 |
| Interest received | | **17** | 8 |
| Acquisition of property, plant and equipment | | **(2,692)** | (2,641) |
| **Net cash used in investing activities** | | **(2,653)** | (2,630) |
| Proceeds from the issue of share capital | | **202** | — |
| Repurchase of own shares | | **(242)** | — |
| Repayment of borrowings | | **(400)** | (400) |
| Dividends paid | | **(1,637)** | (1,634) |
| **Net cash used in financing activities** | | **(2,077)** | (2,034) |
| Net decrease in cash and cash equivalents | | **(653)** | (897) |
| **Cash and cash equivalents at 1 January** | | **(329)** | 432 |
| Effect of exchange rate fluctuations on cash held | | **(2)** | 136 |
| **Cash and cash equivalents at 31 December** | 14 | **(984)** | (329) |

Cash and cash equivalents comprise cash at bank and short-term highly liquid investments with a maturity date of less than three months.

# Company Cash Flow Statement

For the year ended 31 December 2007

| | Note | 2007 £000 | 2006 £000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit for the year | | **2,733** | 571 |
| Adjustments for: | | | |
| Depreciation, amortisation and impairment | | **2,731** | 2,825 |
| Foreign exchange losses | | **56** | 508 |
| Financial income | | **(1,282)** | (1,172) |
| Financial expense | | **1,159** | 1,049 |
| Equity-settled share-based payments | | **91** | 64 |
| Taxation | | **498** | 321 |
| **Operating profit before changes in working capital and provisions** | | **5,986** | 4,166 |
| Increase in trade and other receivables | | **(1,952)** | (34) |
| Increase in inventories | | **(200)** | (54) |
| Increase in trade and other payables | | **497** | 313 |
| Decrease in provisions and employee benefits | | **(600)** | (619) |
| **Cash generated from the operations** | | **3,731** | 3,772 |
| Interest paid | | **(145)** | (128) |
| Tax paid | | **(581)** | (817) |
| **Net cash flow from operating activities** | | **3,005** | 2,827 |
| Proceeds on disposal of property, plant and equipment | | **—** | 3 |
| Interest received | | **236** | 296 |
| Acquisition of property, plant and equipment | | **(2,622)** | (2,574) |
| **Net cash used in investing activities** | | **(2,386)** | (2,275) |
| Proceeds from issue of share capital | | **202** | — |
| Repurchase of own shares | | **(242)** | — |
| Intercompany loan repayment | | **—** | 840 |
| Intercompany loan issued | | **(27)** | — |
| Intercompany loan received | | **653** | — |
| Repayment of borrowings | | **(400)** | (400) |
| Dividends paid | | **(1,637)** | (1,634) |
| **Net cash used in financing activities** | | **(1,451)** | (1,194) |
| Net decrease in cash and cash equivalents | | **(832)** | (642) |
| **Cash and cash equivalents at 1 January** | | **(411)** | 209 |
| Effect of exchange fluctuations on cash held | | **1** | 22 |
| **Cash and cash equivalents at 31 December** | 14 | **(1,242)** | (411) |

# Notes to the Financial Statements

### 1. Accounting policies

Zotefoams plc (the 'Company') is a Company incorporated in Great Britain.

The Group financial statements consolidate those of the Company and its subsidiaries (together referred to as the 'Group'). The Parent Company financial statements present information about the Company as a separate entity and not about its Group.

Both Parent Company financial statements and the Group financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRS").

On publishing the Parent Company financial statements here together with the Group financial statements the Company is taking advantage of the exemption in Section 230 of the Companies Act 1985 not to present its individual Income Statement and related notes that form part of these approved financial statements.

These financial statements were approved by the Board on 3 March 2008.

Judgements made by the Directors, in the application of these accounting policies that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year, are discussed in note 25.

#### a) Measurement convention

The financial statements are prepared on the historical cost basis except that derivative financial instruments are stated at their fair value.

#### b) Basis of consolidation

i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

ii) Transactions eliminated on consolidation

Intra-group balances and transactions, including any unrealised gains and losses or income and expenses arising from such transactions, are eliminated in preparing the financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

#### c) Foreign currency

i) Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the time of the transaction.
Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in profit and loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

ii) Financial statements of foreign operations

The assets and liabilities of foreign operations, including fair value adjustments arising on consolidation, are translated to sterling at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to sterling at the average rate of exchange ruling during the year where this rate approximates to the foreign exchange rates ruling at the dates of the transactions.

Exchange differences arising from this translation of foreign operations since 1 January 2004 are taken directly to translation reserve. They are released into the Income Statement upon disposal.

#### d) Derivative financial instruments

The Group uses derivative financial instruments to hedge its exposure to foreign exchange risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement is recognised immediately in the Income Statement. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see accounting policy e).

The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

#### e) Cash flow hedging

When a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or of a highly probable forecasted transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. If a hedge of a forecasted transaction subsequently results in the recognition of a financial asset or a financial liability, then the associated gains or losses that were recognised directly in equity are reclassified into the Income Statement in the same period or periods during which the asset acquired or liability assumed affects the Income Statement (i.e. when interest income or expense is recognised).

The ineffective part of any gain or loss is recognised immediately in the Income Statement.

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, then the cumulative unrealised gain or loss recognised in equity is recognised immediately in the Income Statement.

**1. Accounting policies continued**

**f) Property, plant and equipment**

i) Owned assets

Items of property, plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment losses (see accounting policy k).

When parts of an item of property, plant and equipment have different useful lives, those components are accounted for as separate items of property, plant and equipment.

The cost of assets under construction includes the cost of materials and direct labour, and any other costs directly attributable to bringing the asset to a working condition for its intended use.

ii) Leased assets

Leases in terms of which the Group assumes substantially all of the risks and rewards of ownership are classified as finance leases. Lease payments are accounted for as described in accounting policy q.

iii) Depreciation

Depreciation is charged to the Income Statement on a straight line basis over the estimated useful lives of each part of the item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

| | |
|---|---|
| Buildings | 20 years |
| Plant and equipment | 5–15 years |
| Fixtures and fittings | 3–5 years |

**g) Intangible assets – research and development**

Expenditure on research activities undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the Income Statement as an expense incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development.

**h) Trade and other receivables**

Trade and other receivables are stated at their nominal amounts less impairment losses (see accounting policy k).

**i) Inventories**

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completing and selling expenses.

In determining the cost of raw materials, consumables and goods purchased for resale, the weighted average purchase price is used. For work in progress and finished goods manufactured by the Group, cost is taken as production cost, which includes an appropriate proportion of attributable overheads.

**j) Cash and cash equivalents**

Cash and cash equivalents comprises cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purposes of the statement of cash flows.

**k) Impairment**

The carrying amounts of the Group's assets, other than inventories (see accounting policy i), employee benefits (see accounting policy n) and deferred tax assets (see accounting policy r), are reviewed at each balance sheet date where there is an indication that the asset may be impaired. If any such indication exists, the asset's recoverable amount is estimated (see below).

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the Income Statement.

i) Calculation of recoverable amount

The recoverable amount of assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

ii) Reversals of impairment

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.
An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

**l) Dividends**

Dividends are recognised as a liability in the period in which they are approved.

**m) Interest-bearing borrowings**

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any differences between cost and redemption values being recognised in the Income Statement over the period of the borrowings on an effective interest basis where material.

# Notes to the Financial Statements continued

**1. Accounting policies continued**

**n) Employee benefits**

i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement as incurred.

ii) Defined benefits plans

The Group's net obligation in respect of defined benefit post employment plans, including pension plans, is calculated separately for each plan by estimating the amount of future benefit that the employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AA credit rated bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

The Group recognises all actuarial gains and losses that arise through the Statement of Recognised Income and Expense.

iii) Share-based payment transactions

The share option programme allows Group employees to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employee becomes unconditionally entitled to the options. The fair value of the options granted before 2006 were measured using a Monte Carlo simulation method. Options granted in since 1 January 2006 are valued using a Black-Scholes model. Fair value measurements take into account the terms and conditions upon which the options were granted.

**o) Trade and other payables**

Trade and other payables are stated at cost.

**p) Revenue**

Revenue from the sale of goods is recognised in the Income Statement at the point of despatch when significant risks and rewards of ownership is deemed to have been transferred to the buyer.

**q) Expenses**

i) Operating lease payments

Payments made under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease. Lease incentives received are recognised in the Income Statement as an integral part of the total lease expenses.

ii) Finance lease payments

The finance charge, where material, is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

**r) Taxation**

Tax on the Income Statement for the periods presented comprises current and deferred tax. Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is more likely than not that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional tax that arises from the distribution of dividends is recognised at the same time as the liability to pay the related dividend.

Information as to the calculation of tax on the Income Statement is included in note 7.

**s) Segmental reporting**

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

**t) Investments in equity securities**

Investments in subsidiaries are stated at cost less impairment.

### 1. Accounting policies continued

### u) Adopted IFRS not yet applied

A number of relevant new standards, amendment to standards and interpretations are not yet effective for the year ended 31 December 2007 and have not been applied in preparing these consolidated financial statements:

IFRS 8 Operating Segments introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Group's 2009 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. Currently the Group presents information under two operating and four geographical segments. The Group will review the implications of IFRS 8 in preparing its 2009 financial statements.

Revised IAS 23 Borrowing Costs removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The revised IAS 23 will become mandatory for the Group's 2009 financial statements and may constitute a change in accounting policy for the Group. The Group will review the implications of IAS 23 in preparing its 2009 financial statements.

IFRIC 11 IFRS 2 – Group and Treasury Share Transactions requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Group's 2008 financial statements, with retrospective application required. It is not expected to have any impact on the consolidated financial statements.

IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Group's 2008 financial statements, with retrospective application required. The Group has not yet determined the potential effect of the interpretation.

IFRIC 12 Service concession arrangements. This will become mandatory for the Group's 2008 financial statements and is not expected to have any impact on the consolidated financial statements.

IFRIC 13 Customer loyalty programmes. This will become mandatory for the Group's 2009 financial statements and is not expected to have any impact on the consolidated financial statements.

### 2. Segment reporting

The Group manufactures and sells high-performance foams for specialist markets worldwide. These fall into two main business segments best categorised by their constituent raw materials.

• Polyolefins: these foams are made from olefinic homopolymer and copolymer resin. The most common resin used is polyethylene.

• High-performance polymers (HPP): these foams exhibit high-performance on certain key properties, such as improved chemical, flammability or temperature performance, due to the resins on which they are based. Turnover in the segment is currently mainly derived from our ZOTEK® F foams made from PVDF fluoropolymer. Other polymers either commercially launched or being assessed in development include polyamide (nylon).

Due to our unique manufacturing technology Zotefoams can produce polyolefin foams with superior performance to other manufacturers. Our strategy is to use the capabilities of our technology to produce foams from other materials in addition to polyolefins. The development of foams from high-performance polymers is currently in its early stages with costs (including the technical and marketing costs to develop these materials) exceeding revenues.

| | | Polyolefins | | HPP | | Consolidated | |
|---|---|---|---|---|---|---|---|
| | Note | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 |
| Revenue | | **30,872** | 29,558 | **734** | 494 | **31,606** | 30,052 |
| Pre-exceptional profit/(loss) | | **4,001** | 3,369 | **(540)** | (533) | **3,461** | 2,836 |
| Exceptional items | 4 | **—** | (1,074) | **—** | — | **—** | (1,074) |
| Post-exceptional profit/(loss) | | **4,001** | 2,295 | **(540)** | (533) | **3,461** | 1,762 |
| Net financing costs | | | | | | **(89)** | (163) |
| Taxation | | | | | | **(454)** | (360) |
| Profit for the year | | | | | | **2,918** | 1,239 |
| Segment assets | | **36,434** | 35,716 | **1,891** | 1,332 | **38,325** | 37,048 |
| Unallocated assets | | **—** | — | **—** | — | **138** | 99 |
| Total assets | | | | | | **38,463** | 37,147 |
| Segment liabilities | | **(8,370)** | (9,123) | **(167)** | (115) | **(8,537)** | (9,238) |
| Unallocated liabilities | | **—** | — | **—** | — | **(3,260)** | (3,071) |
| Total liabilities | | | | | | **(11,797)** | (12,309) |
| Depreciation | | **3,093** | 3,188 | **36** | 63 | **3,129** | 3,251 |
| Capital expenditure | | **2,600** | 2,287 | **92** | 354 | **2,692** | 2,641 |

# Notes to the Financial Statements continued

### 2. Segment reporting continued
### Geographical segments

| | UK and Eire £000 | Europe £000 | North America £000 | Rest of the World £000 | Total £000 |
|---|---|---|---|---|---|
| For the year ended 31 December 2007 | | | | | |
| Revenue from external customers | **8,180** | **15,249** | **7,131** | **1,046** | **31,606** |
| Segment assets | **30,881** | **—** | **7,582** | **—** | **38,463** |
| Capital expenditure | **2,622** | **—** | **70** | **—** | **2,692** |
| For the year ended 31 December 2006 | | | | | |
| Revenue from external customers | 7,543 | 14,391 | 7,504 | 614 | 30,052 |
| Segment assets | 29,746 | — | 7,401 | — | 37,147 |
| Capital expenditure | 2,574 | — | 67 | — | 2,641 |

### 3. Expenses and auditors' remuneration

| | **2007 £000** | 2006 £000 |
|---|---|---|
| Included in profit for the year are: | | |
| Research and development costs expensed | **803** | 924 |
| Net exchange (gains)/losses | **(227)** | 147 |
| Auditors' remuneration: | | |
| Group – audit of these financial statements | **84** | 80 |
| – fees receivable by the auditors and their associates in respect of other services: | | |
| – other services pursuant with legislation | **18** | 18 |
| – other services relating to taxation | **11** | 5 |
| | **113** | 103 |

### 4. Exceptional items
In 2006 the Company classified the following items as exceptional:

**Bid costs**
Relating to legal, advisory and other costs incurred in respect of a preliminary approach for the share capital of the Company which was announced in January 2005 and terminated in November 2005.

**Commercial agreement termination costs**
Relating to the termination payment, legal, advisory and other costs to end the commercial relationship with the Sekisui Group which was announced in March 2006.

**Tax adjustment to exceptional items in prior year**

| | **2007 £000** | 2006 £000 |
|---|---|---|
| Bid costs | **—** | 30 |
| Commercial agreement termination | **—** | (1,104) |
| Exceptional items before taxation | **—** | (1,074) |
| Tax on above | **—** | 322 |
| Exceptional items after taxation | **—** | (752) |

### 5. Staff numbers and expenses
The average number of people employed by the Group and Company (including Directors) during the year, analysed by category, was as follows:

| | Number of employees | | | |
|---|---|---|---|---|
| | Group | | Company | |
| | **2007** | 2006 | **2007** | 2006 |
| Production | **134** | 133 | **124** | 123 |
| Maintenance | **17** | 19 | **14** | 16 |
| Distribution and marketing | **33** | 33 | **27** | 25 |
| Administration and technical | **62** | 60 | **54** | 52 |
| | **246** | 245 | **219** | 216 |

The aggregate payroll costs of these persons were as follows (£000s):

| | | | | |
|---|---|---|---|---|
| Wages and salaries | **7,330** | 6,777 | **6,611** | 5,913 |
| Social security costs | **801** | 780 | **663** | 602 |
| Share-based payments | **91** | 64 | **91** | 64 |
| Other pension costs | **590** | 606 | **554** | 521 |
| | **8,812** | 8,227 | **7,919** | 7,100 |

Details of individual Directors' emoluments, pension costs and share options are dealt with on pages 22 to 26 in the Directors' Remuneration Report.

## 6. Finance income and costs

### Financial income

| | 2007 £000 | 2006 £000 |
|---|---|---|
| Interest on bank deposits | **17** | 8 |
| Expected return on assets of defined benefit pension fund | **1,046** | 876 |
| | **1,063** | 884 |

### Finance costs

| | | |
|---|---|---|
| On bank loans and overdrafts | **140** | 125 |
| Interest on defined benefit pension obligation | **1,012** | 922 |
| | **1,152** | 1,047 |

## 7. Taxation

| | Note | 2007 £000 | 2006 £000 |
|---|---|---|---|
| UK corporation tax | | **904** | 484 |
| Overseas taxation | | **(5)** | 6 |
| Adjustment to prior year UK tax charge | | **(81)** | (60) |
| Current taxation | | **818** | 430 |
| Deferred taxation | 17 | **(364)** | (70) |
| Total tax charge | | **454** | 360 |

### Factors affecting the tax charge

The tax charge for the period is lower (2006: lower) than the standard rate of corporation tax in the UK of 30% (2006: 30%). The differences are explained below:

| | 2007 £000 | 2006 £000 |
|---|---|---|
| Tax reconciliation | | |
| Profit on ordinary activities before tax | **3,372** | 1,599 |
| Tax at 30% (2006: 30%) | **1,011** | 480 |
| Effects of: | | |
| Research and development tax credits less expenses not deductible for tax purposes | **(39)** | (53) |
| Deferred tax rate change from 30% to 28% | **(204)** | — |
| Partial recognition of US tax losses | **(32)** | (1) |
| Lower tax rates on overseas earnings | **(51)** | (6) |
| Adjustments to UK corporation tax charge in respect of previous periods | **(81)** | (60) |
| Adjustments to deferred tax charge in respect of previous periods | **(150)** | — |
| Total tax charge | **454** | 360 |

In June 2007 a reduction in the UK tax rate from 30% to 28%, which will be effective from 1 April 2008, was substantially enacted. In accordance with IAS12 Income Taxes, the deferred tax liability and assets have been calculated using a rate of 28%.

## 8. Dividends and earnings per share

| | 2007 £000 | 2006 £000 |
|---|---|---|
| Final dividend prior year of 3.0p (2005: 3.0p) net per 5.0p ordinary share | **1,090** | 1,087 |
| Interim dividend of 1.5p (2006: 1.5p) net per 5.0p ordinary share | **547** | 547 |
| Dividends paid during the year | **1,637** | 1,634 |

The proposed final dividend for the year ended 31 December 2007 of 3.0p per share (2006: 3.0p) is subject to approval by shareholders at the AGM and has not been included as a liability in these financial statements.

### Earnings per ordinary share

Earnings per ordinary share is calculated by dividing profit after tax of £2,918,000 (2006: £1,239,000) by the weighted average number of shares in issue during the year. Diluted earnings per ordinary share adjusts for the potential dilutive effect of share option schemes in accordance with IAS 33.

| | 2007 | 2006 |
|---|---|---|
| Average number of ordinary shares issued | **36,375,270** | 36,319,924 |
| Deemed issued for no consideration | **692,568** | 339,875 |
| Diluted | **37,067,838** | 36,659,799 |

# Notes to the Financial Statements continued

### 8. Dividends and earnings per share continued

**Earnings per ordinary share**

Shares deemed issued for no consideration have been calculated based on the potential dilutive effect of the Executive Share Option Scheme, options granted under the HMRC Approved Share Option Scheme and Long Term Incentive Plans:

| | | Number of shares under option | |
|---|---|---|---|
| Date from which exercisable | Exercise price | **2007** | 2006 |
| 7 April 2007 | 72.5p | **152,834** | 1,130,034 |
| 22 December 2008 | 77.0p | **1,026,320** | 1,026,320 |
| 27 March 2009 | 80.5p | **—** | 111,801 |
| 10 May 2010 | nil | **306,959** | — |
| | | **1,486,113** | 2,268,155 |

The average fair value of one ordinary share during the year was considered to be 113.6p (2006: 88.3p).

### 9. Profit for the financial year

The Group accounts do not include a separate Income Statement for Zotefoams plc (the parent undertaking) as permitted by Section 230 of the Companies Act 1985. The Parent Company profit after tax for the financial year is £2,733,000 (2006: £571,000).

### 10. Property, plant and equipment

**a) Group**

| | Land and buildings £000 | Plant and equipment £000 | Fixtures and fittings £000 | Under construction £000 | Total £000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2006 | 14,693 | 37,410 | 2,151 | 1,123 | 55,377 |
| Acquisitions | — | 1,461 | 32 | 1,169 | 2,662 |
| Disposals | — | (101) | (351) | — | (452) |
| Reclassifications | — | 177 | (4) | (173) | — |
| Effect of movement in foreign exchange | (500) | (489) | (17) | — | (1,006) |
| Balance at 31 December 2006 | 14,193 | 38,458 | 1,811 | 2,119 | 56,581 |
| Balance at 1 January 2007 | 14,193 | 38,458 | 1,811 | 2,119 | 56,581 |
| Acquisitions | — | 114 | 159 | 2,374 | 2,647 |
| Disposals | — | (21) | — | — | (21) |
| Reclassifications | — | 2,305 | 14 | (2,319) | — |
| Effect of movement in foreign exchange | (60) | (60) | (2) | — | (122) |
| **Balance at 31 December 2007** | **14,133** | **40,796** | **1,982** | **2,174** | **59,085** |
| **Depreciation and impairment** | | | | | |
| Balance at 1 January 2006 | 3,647 | 21,251 | 2,041 | 74 | 27,013 |
| Depreciation charge for the year | 574 | 2,538 | 72 | 67 | 3,251 |
| Disposals | — | (98) | (351) | — | (449) |
| Reclassifications | — | 14 | (8) | (6) | — |
| Effect of movement in foreign exchange | (91) | (149) | (12) | — | (252) |
| Balance at 31 December 2006 | 4,130 | 23,556 | 1,742 | 135 | 29,563 |
| Balance at 1 January 2007 | 4,130 | 23,556 | 1,742 | 135 | 29,563 |
| Depreciation charge for the year | 562 | 2,504 | 63 | — | 3,129 |
| Disposals | — | (12) | — | — | (12) |
| Reclassifications | — | 135 | — | (135) | — |
| Effect of movement in foreign exchange | (11) | (19) | (1) | — | (31) |
| **Balance at 31 December 2007** | **4,681** | **26,164** | **1,804** | **—** | **32,649** |
| **Net book value** | | | | | |
| At 1 January 2006 | 11,046 | 16,159 | 110 | 1,049 | 28,364 |
| At 31 December 2006 and 1 January 2007 | 10,063 | 14,902 | 69 | 1,984 | 27,018 |
| **At 31 December 2007** | **9,452** | **14,632** | **178** | **2,174** | **26,436** |

Included in plant and machinery for both the Company and the Group are assets of £700,000 (2006: £1,100,000) pledged as security for a bank loan.

During the year both the Company and the Group commenced a number of programmes to construct and refurbish plant and equipment and fixtures and fittings. Costs incurred up to the balance sheet date totalled £2,174,000 (2006: £2,119,000) for the Group.

## 10. Property, plant and equipment

### b) Company

| | Land and buildings £000 | Plant and equipment £000 | Fixtures and fittings £000 | Under construction £000 | Total £000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2006 | 10,590 | 33,022 | 2,031 | 1,123 | 46,766 |
| Acquisitions | — | 1,411 | 15 | 1,169 | 2,595 |
| Disposals | — | (101) | (351) | — | (452) |
| Reclassifications | — | 177 | (4) | (173) | — |
| Balance at 31 December 2006 | 10,590 | 34,509 | 1,691 | 2,119 | 48,909 |
| Balance at 1 January 2007 | 10,590 | 34,509 | 1,691 | 2,119 | 48,909 |
| Acquisitions | — | 70 | 133 | 2,374 | 2,577 |
| Disposals | — | — | — | — | — |
| Reclassifications | — | 2,305 | 14 | (2,319) | — |
| **Balance at 31 December 2007** | **10,590** | **36,884** | **1,838** | **2,174** | **51,486** |
| **Depreciation and impairment** | | | | | |
| Balance at 1 January 2006 | 2,951 | 19,734 | 1,944 | 74 | 24,703 |
| Depreciation charge for the year | 421 | 2,276 | 61 | 67 | 2,825 |
| Disposals | — | (98) | (351) | — | (449) |
| Reclassifications | — | 14 | (8) | (6) | — |
| Balance at 31 December 2006 | 3,372 | 21,926 | 1,646 | 135 | 27,079 |
| Balance at 1 January 2007 | 3,372 | 21,926 | 1,646 | 135 | 27,079 |
| Depreciation charge for the year | 421 | 2,262 | 48 | — | 2,731 |
| Disposals | — | — | — | — | — |
| Reclassifications | — | 131 | 4 | (135) | — |
| **Balance at 31 December 2007** | **3,793** | **24,319** | **1,698** | **—** | **29,810** |
| **Net book value** | | | | | |
| At 1 January 2006 | 7,639 | 13,288 | 87 | 1,049 | 22,063 |
| At 31 December 2006 and 1 January 2007 | 7,218 | 12,583 | 45 | 1,984 | 21,830 |
| **At 31 December 2007** | **6,797** | **12,565** | **140** | **2,174** | **21,676** |

## 11. Investments in subsidiaries

| | Company | |
|---|---|---|
| | **2007 £000** | 2006 £000 |
| Shares in Group undertakings – at cost | **5,651** | 5,651 |
| Provision against the value of investment in subsidiary to reflect the value of the underlying net assets | **(3,294)** | (3,294) |
| Loan to Zotefoams Inc. | **3,265** | 3,321 |
| Loan to EBT | **27** | — |
| | **5,649** | 5,678 |

The investments consist of the entire ordinary share capital of Zotefoams International Limited, a $6,500,000 loan (2006: $6,500,000) to Zotefoams Inc. and a £27,000 loan (2006: nil) to Zotefoams Employee Benefit Trust.

The movements in investments during the year were:

- loan to Zotefoams Employee Benefit Trust of £27,000.
- foreign exchange differences.

The following is a complete list of the subsidiary undertakings of the Company, in all of which the Company owns either directly or indirectly 100% of the ordinary share capital:

- Zotefoams International Limited; and
- Zotefoams Inc.

Zotefoams International Limited is incorporated in Great Britain, and Zotefoams Inc. is incorporated in the USA.

The principal activities of the subsidiary undertakings are as follows: Zotefoams Inc. purchases, manufactures and distributes cross-linked block foams and Zotefoams International Limited is a holding Company. In the opinion of the Directors the investments in the Company's subsidiary undertakings are worth at least the amount at which they are stated in the Balance Sheet.

# Notes to the Financial Statements continued

## 12. Inventories

| | Group 2007 £000 | Group 2006 £000 | Company 2007 £000 | Company 2006 £000 |
|---|---|---|---|---|
| Raw materials and consumables | **1,556** | 1,469 | **1,528** | 1,446 |
| Work in progress | **1,226** | 1,125 | **949** | 1,017 |
| Finished goods | **1,498** | 1,191 | **878** | 692 |
| | **4,280** | 3,785 | **3,355** | 3,155 |

The carrying amount of inventories subject to retention of title clauses is £302,000 (2006: £252,000).
In 2007 the value of inventory recognised by the Group as an expense in cost of goods sold was £18,791,000 (2006:£18,673,000).

## 13. Trade and other receivables

| | Note | Group 2007 £000 | Group 2006 £000 | Company 2007 £000 | Company 2006 £000 |
|---|---|---|---|---|---|
| Amounts falling due within one year: | | | | | |
| Trade receivables | | **7,115** | 5,875 | **5,628** | 4,476 |
| Fair value derivatives | 20 | **8** | 85 | **8** | 85 |
| Amounts owed by Group undertakings | | **—** | — | **1,655** | 879 |
| Other receivables | | **90** | 49 | **90** | 49 |
| Prepayments and accrued income | | **138** | 154 | **133** | 150 |
| | | **7,351** | 6,163 | **7,514** | 5,639 |
| Trade receivables are shown net of: impairment losses | | **97** | 70 | **80** | 63 |

## 14. Cash and cash equivalents/bank overdrafts

| | Group 2007 £000 | Group 2006 £000 | Company 2007 £000 | Company 2006 £000 |
|---|---|---|---|---|
| Cash and cash equivalents per balance sheet | **258** | 82 | **—** | — |
| Bank overdrafts | **(1,242)** | (411) | **(1,242)** | (411) |
| Cash and equivalents per cash flow statements | **(984)** | (329) | **(1,242)** | (411) |

## 15. Trade and other payables

| | Note | Group 2007 £000 | Group 2006 £000 | Company 2007 £000 | Company 2006 £000 |
|---|---|---|---|---|---|
| Trade payables | | **700** | 1,056 | **657** | 1,047 |
| Other creditors including taxation and social security: | | | | | |
| Other taxation and social security | | **235** | 193 | **214** | 183 |
| Fair value derivatives | 20 | **193** | 1 | **193** | 1 |
| Other payables | | **745** | 494 | **670** | 389 |
| Accruals and deferred income | | **2,257** | 1,743 | **2,214** | 1,682 |
| | | **4,130** | 3,487 | **3,948** | 3,302 |

## 16. Interest-bearing loans and borrowings

| | Note | Group 2007 £000 | Group 2006 £000 | Company 2007 £000 | Company 2006 £000 |
|---|---|---|---|---|---|
| Bank loans | | **400** | 400 | **400** | 400 |
| Amounts due to Group undertakings | | **—** | — | **653** | — |
| Amounts falling due within one year | | **400** | 400 | **1,053** | 400 |
| Bank loans | | **300** | 700 | **300** | 700 |
| Amounts falling due in more than one year | | **300** | 700 | **300** | 700 |
| | 20 | **700** | 1,100 | **1,353** | 1,100 |

## 17. Deferred tax assets and liabilities

### Recognised deferred tax assets and liabilities – Group

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 |
| Property, plant and equipment | **—** | — | **2,603** | 3,090 | **2,603** | 3,090 |
| Rolled-over gain | **—** | — | **902** | 967 | **902** | 967 |
| Inventories | **(51)** | (44) | **—** | — | **(51)** | (44) |
| Financial instruments | **(52)** | — | **—** | 25 | **(52)** | 25 |
| Employee benefits | **(754)** | (1,318) | **—** | — | **(754)** | (1,318) |
| Tax value of recognised losses carried forward | **(87)** | (55) | **—** | — | **(87)** | (55) |
| Tax (assets)/liabilities | **(944)** | (1,417) | **3,505** | 4,082 | **2,561** | 2,665 |
| Set off tax | **806** | 1,318 | **(806)** | (1,318) | **—** | — |
| Net tax (assets)/liabilities | **(138)** | (99) | **2,699** | 2,764 | **2,561** | 2,665 |

At 31 December 2007 a deductible temporary difference of £638,000 (2006: £549,000) relating to undistributed reserves in a subsidiary has not been recognised because the Group controls whether the liability will be incurred and is satisfied that it will not be incurred in the foreseeable future.

### Unrecognised deferred tax assets

The Group has $6.3m of tax losses carried forward in the USA. These tax losses at a 35% tax rate and year end exchange rates have a value of £1.1m. The Group has only recognised £87,000 of these tax losses as a deferred tax asset representing what the Board believe is a reasonable estimate of the expected US tax utilisation in the near future.

### Movement in deferred tax during the year

| | Balance 1 January 2007 £000 | Recognised in income £000 | Recognised in equity £000 | **Balance 31 December 2007 £000** |
|---|---|---|---|---|
| Property, plant and equipment | 3,090 | (487) | — | **2,603** |
| Rolled-over gain | 967 | (65) | — | **902** |
| Inventories | (44) | (7) | — | **(51)** |
| Financial instruments | 25 | | (77) | **(52)** |
| Employee benefits | (1,318) | 227 | 337 | **(754)** |
| Tax value of recognised losses carried forward | (55) | (32) | — | **(87)** |
| | 2,665 | (364) | 260 | **2,561** |

### Movement in deferred tax during the prior year

| | Balance 1 January 2006 £000 | Recognised in income £000 | Recognised in equity £000 | Balance 31 December 2006 £000 |
|---|---|---|---|---|
| Property, plant and equipment | 3,327 | (237) | — | 3,090 |
| Rolled-over gain | 967 | — | — | 967 |
| Inventories | (78) | 34 | — | (44) |
| Financial instruments | — | — | 25 | 25 |
| Employee benefits | (1,564) | 134 | 112 | (1,318) |
| Tax value of recognised losses carried forward | (54) | (1) | — | (55) |
| | 2,598 | (70) | 137 | 2,665 |

### Deferred tax assets and liabilities – Company

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 |
| Property, plant and equipment | **—** | — | **2,603** | 3,090 | **2,603** | 3,090 |
| Rolled-over gain | **—** | — | **902** | 967 | **902** | 967 |
| Financial instruments | **(52)** | — | **—** | 25 | **(52)** | 25 |
| Employee benefits | **(754)** | (1,318) | **—** | — | **(754)** | (1,318) |
| Tax (assets)/liabilities | **(806)** | (1,318) | **3,505** | 4,082 | **2,699** | 2,764 |
| Set off tax | **806** | 1,318 | **(806)** | (1,318) | **—** | — |
| Net tax liabilities | **—** | — | **2,699** | 2,764 | **2,699** | 2,764 |

# Notes to the Financial Statements continued

### 17. Deferred tax assets and liabilities continued
**Movement in deferred tax during the year**

| | Balance 1 January 2007 £000 | Recognised in income £000 | Recognised in equity £000 | **Balance 31 December 2007 £000** |
|---|---|---|---|---|
| Property, plant and equipment | 3,090 | (487) | — | **2,603** |
| Rolled-over gain | 967 | (65) | — | **902** |
| Financial instruments | 25 | — | (77) | **(52)** |
| Employee benefits | (1,318) | 227 | 337 | **(754)** |
| | 2,764 | (325) | 260 | **2,699** |

**Movement in deferred tax during the prior year**

| | Balance 1 January 2006 £000 | Recognised in income £000 | Recognised in equity £000 | Balance 31 December 2006 £000 |
|---|---|---|---|---|
| Property, plant and equipment | 3,327 | (237) | — | 3,090 |
| Rolled-over gain | 967 | — | — | 967 |
| Financial instruments | — | — | 25 | 25 |
| Employee benefits | (1,564) | 134 | 112 | (1,318) |
| | 2,730 | (103) | 137 | 2,764 |

### 18. Share capital

| | **2007 £** | 2006 £ |
|---|---|---|
| Authorised | | |
| At 31 December | | |
| Equity: 56,000,000 ordinary shares of 5.0p each | **2,800,000** | 2,800,000 |
| Allotted, called-up and fully paid | | |
| At 31 December | | |
| Equity: 36,402,608 (2006: 36,319,924) ordinary shares of 5.0p each | **1,820,130** | 1,815,996 |

Details of share options are provided in note 8 to the accounts on pages 45 and 46.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

### 19. Capital and reserves
**Reconciliation of movement in capital and reserves – Group**

| | Share capital £000 | Share premium £000 | Capital redemption reserve £000 | Translation reserve £000 | Hedging reserve £000 | Retained Earnings £000 | Total equity £000 |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2006** | 1,816 | 13,753 | 5 | 270 | (79) | 9,857 | 25,622 |
| Total recognised income and expense | — | — | — | (905) | 163 | 1,506 | 764 |
| Equity-settled share-based payment transactions net of tax | — | — | — | — | — | 86 | 86 |
| Dividends | — | — | — | — | — | (1,634) | (1,634) |
| **Balance at 31 December 2006** | 1,816 | 13,753 | 5 | (635) | 84 | 9,815 | 24,838 |
| Balance at 1 January 2007 | 1,816 | 13,753 | 5 | (635) | 84 | 9,815 | 24,838 |
| Shares issued | 14 | 188 | — | — | — | — | 202 |
| Shares purchased | (10) | — | 10 | — | — | (242) | (242) |
| Total recognised income and expense | — | — | — | (117) | (269) | 3,788 | 3,402 |
| Equity-settled share-based payment transactions net of tax | — | — | — | — | — | 103 | 103 |
| Dividends | — | — | — | — | — | (1,637) | (1,637) |
| **Balance at 31 December 2007** | **1,820** | **13,941** | **15** | **(752)** | **(185)** | **11,827** | **26,666** |

The aggregate current and deferred tax relating to items that are charged to equity is £260,000 (2006: £137,000).

## 19. Capital and reserves continued

### Reconciliation of movement in capital and reserves – Company

| | Share capital £000 | Share premium £000 | Capital redemption reserve £000 | Hedging reserve £000 | Retained earnings £000 | Total equity £000 |
|---|---|---|---|---|---|---|
| **Balance at 1 January 2006** | 1,816 | 13,753 | 5 | (79) | 9,218 | 24,713 |
| Total recognised income and expense | — | — | — | 163 | 838 | 1,001 |
| Equity-settled share-based payment transactions net of tax | — | — | — | — | 86 | 86 |
| Dividends | — | — | — | — | (1,634) | (1,634) |
| **Balance at 31 December 2006** | 1,816 | 13,753 | 5 | 84 | 8,508 | 24,166 |
| Balance at 1 January 2007 | 1,816 | 13,753 | 5 | 84 | 8,508 | 24,166 |
| Shares issued | 14 | 188 | — | — | — | 202 |
| Shares purchased | (10) | | 10 | — | (242) | (242) |
| Total recognised income and expense | — | — | — | (269) | 3,603 | 3,334 |
| Equity-settled share-based payment transactions net of tax | — | — | — | — | 103 | 103 |
| Dividends | — | — | — | — | (1,637) | (1,637) |
| **Balance at 31 December 2007** | **1,820** | **13,941** | **15** | **(185)** | **10,335** | **25,926** |

The aggregate current and deferred tax relating to items that are charged to equity is £260,000 (2006: £137,000).

### Translation reserve

Translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations.

### Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedging transactions that have not yet occurred.

## 20. Financial instruments

### Policy

The Group's principal financial instruments include bank loans, cash and short-term deposits the main purpose of which is to raise finance for the Group's operations. Foreign exchange derivatives are used to help manage the Group's currency exposure. 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 credit risk, interest rate risk, liquidity risk and foreign exchange risk. The Board reviews and agrees policies for managing each of these risks and they are summarised overleaf. These policies have remained fundamentally unchanged throughout the year.

### Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. The Group does not require collateral in respect of financial assets.

In 2007 and 2006, the Group had credit insurance to mitigate this risk. However, not all the exposure is covered so elements of risk remain.

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the Balance Sheet.

### Interest rate risk

The Group finances its operations through a mixture of retained profits and bank borrowings. The Group borrows in the desired currency generally at a variable rate of interest.

The interest rate profile of the Group's borrowings at 31 December was:

| | | | | **2007** | | | | 2006 |
|---|---|---|---|---|---|---|---|---|
| | **Effective interest rate** | **Fixed rates £000** | **Variable rates £000** | **Total £000** | Effective interest rate | Fixed rates £000 | Variable rates £000 | Total £000 |
| Sterling | **6%** | **—** | **1,942** | **1,942** | 6% | — | 1,511 | 1,511 |
| | | **—** | **1,942** | **1,942** | | — | 1,511 | 1,511 |

The interest rate payable on the sterling overdraft is determined by LIBOR (or similar) plus a bank margin.

### Liquidity risk

The Group's objective is to maintain a balance of continuity of funding and flexibility through the use of overdrafts, loans and finance leases as applicable. The maturity profile of the Group's borrowings is shown in note 16 on page 48.

The Group has a short-term facility of £5m which is freely transferable and convertible into sterling.

This facility expires at the end of April 2008 and is utilised by Zotefoams and its subsidiary undertakings under a cross-guarantee structure.

On 25 August 2004 Zotefoams borrowed £2.0m under a five year mortgage, repayable in equal quarterly instalments. This facility is secured over specific plant assets. At 31 December 2007 £0.7m of this mortgage was outstanding and £1.3m had been repaid.

# Notes to the Financial Statements continued

### 20. Financial instruments continued

#### Foreign currency risk

The Group is exposed to foreign currency risk on sales, purchases, assets and liabilities which are denominated in a currency other than sterling. The currencies giving rise to this risk are primarily the euro and the US dollar.

The euro and US dollar rates used in preparing the accounts are as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | **Average** | **Closing** | Average | Closing |
| Euro/sterling | **1.46** | **1.36** | 1.47 | 1.48 |
| US dollar/sterling | **2.00** | **1.99** | 1.85 | 1.96 |

The Group hedges a proportion of its estimated cash exposure in respect of trade and other receivables, trade and other payables and forecast sales receipts and purchase payments for the next nine months. The Group uses forward exchange contracts to hedge its foreign currency risk. As at 31 December 2007 these forward currency contracts covered approximately two-thirds of the estimated net cash foreign exchange exposure for the next nine months. Further details are shown below in the paragraph on sensitivity analysis.

In respect of other monetary assets and liabilities held in currencies other than the euro and the US dollar, the Group ensures that the net exposure is kept to a manageable level, by buying or selling foreign currencies at spot rates where necessary to address short-term imbalances.

#### Forecasted transactions

The Group classifies its forward exchange contracts hedging forecasted transactions as cash flow hedges and states them at fair value. The net fair value of forward exchange contracts used as hedges of forecasted transactions at 31 December 2007 was a net liability of £185,000 (2006: net asset of £84,000) comprising assets of £8,000 (2006: £85,000) and liabilities of £193,000 (2006: £1,000) that were recognised in fair value derivatives in 2007.

#### Recognised assets and liabilities

Changes in the fair value of forward exchange contracts that economically hedge monetary assets and liabilities in foreign currencies and for which no hedge accounting is applied are recognised in the Income Statement. Both the changes in fair value of the forward contracts and the foreign exchange gains and losses relating to the monetary items are recognised as part of administrative expenses (see note 3).

#### Sensitivity analysis

In managing currency risks the Group aims to reduce impact of short-term fluctuations on the Group's earnings. Over the longer-term, however, permanent changes in foreign exchange and interest rates would have an impact on consolidated earnings.

Short-term fluctuations in interest rates are not hedged as the Group, at present, does not consider them material. At 31 December 2007 it is estimated that a general increase of one percentage point in interest rates would decrease the Group's profit before tax by approximately £19,000 (2006: £15,000).

At 31 December 2007 it is estimated that an increase of one percentage point in the value of sterling against the euro and the US dollar would decrease the Group's profit before tax by approximately £67,000 (2006: £64,000) before forward exchange contracts and £33,000 (2006: £44,000) after forward exchange contracts are included for the euro and £52,000 (2006:£47,000) for the US dollar before forward exchange contracts and £24,000 (2006: £30,000) after forward exchange contracts are included.

The Group has significant undertakings in the USA whose revenue and expenses are denominated in US dollars. Zotefoams makes a significant proportion of its sales to European customers and these revenues are predominantly in euros. It was the Group's policy in 2007 to hedge the foreign currency cash flows of invoiced sales net of expected foreign expenditure. Hedging is achieved by the use of foreign currency contracts expiring in the month of expected cash flow.

#### Fair values

The fair values together with the carrying amounts shown in the Balance Sheet are as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | **Carrying amount £000** | **Fair value £000** | Carrying amount £000 | Fair value £000 |
| Trade and other receivables | **7,343** | **7,343** | 6,078 | 6,078 |
| Cash and cash equivalents | **(984)** | **(984)** | (329) | (329) |
| Forward exchange contracts | | | | |
| – assets | **8** | **8** | 85 | 85 |
| – liabilities | **(193)** | **(193)** | (1) | (1) |
| Secured bank loans | **(700)** | **(700)** | (1,100) | (1,100) |
| Trade and other payables | **(3,937)** | **(3,937)** | (3,486) | (3,486) |

#### Estimation of fair values

The following summarises the major methods and assumptions used in estimating fair values of financial instruments reflected in the table.

#### Derivatives

Forward exchange contracts are marked to market using listed market prices.

#### Interest-bearing loans and borrowings and trade and other receivables/payables

Carrying amounts equals the fair value.

## 21. Commitments

| | 2007 £000 | 2006 £000 |
|---|---|---|
| (i) Capital contracts at the end of the financial year for which no provision has been made | **334** | 689 |
| (ii) The Group has non-cancellable operating lease rentals, which are payable as follows: | | |
| – within one year | **47** | 63 |
| – between two and five years | **148** | 2 |

During the year ended 31 December 2007 £63,000 was recognised as an expense in the Income Statement in respect of operating leases (2006: £74,000).

The above amounts apply to both the Company and the Group.

## 22. Employee benefits

The Group and Company operate one defined benefit scheme in the UK which offers both pensions in retirement and death benefits to members. Pension benefits are related to the members' final salary at retirement and their length of service. Since 1 October 2001 the scheme has been closed to new members.

From 31 December 2005 future accrual of benefits for existing members of the scheme ceased.

Contributions to the plan for the year from the Company have been agreed with the Trustees at £50,000 per month from January 2006 to December 2010.

The Company has opted to recognise all actuarial gains and losses immediately via the Statement of Recognised Income and Expenditure (SORIE). An actuarial valuation of the scheme was carried out as at 5 April 2005 and the results have been updated to 31 December 2007 by a qualified independent actuary. The major assumptions used by the actuary were (in nominal terms) as follows:

| | As at 31 December 2007 | As at 31 December 2006 |
|---|---|---|
| Discount rate | **5.90%** | 5.10% |
| Expected return on plan assets | **6.62%** | 6.58% |
| Rate of salary increase | **n/a** | n/a |
| Rate of increase to pensions in payment | **3.30%** | 3.00% |
| Rate of inflation | **3.40%** | 3.10% |
| Mortality assumption | **PA92 MC** | 90% of PA92 |
| Life expectancy from age 65 of current male pensioners | **22.5 years** | 20.7 years |

The overall expected return on assets assumption of 6.62% as at 31 December 2007 has been derived by calculating the weighted average of the expected rate of return for each asset class. The following approach has been used to determine the expected rate of return for each asset class:

- Equities - allowance for an additional return of 2.5% above that available on gilts;
- Gilts - derived from the yield on 15-year fixed interest gilts; and
- Cash - based on the Bank of England base rate.

| | Year ended 31 December 2007 | | Year ended 31 December 2006 | |
|---|---|---|---|---|
| **Present value of scheme assets:** | Long-term rate of return expected | Market value £000 | Long-term rate of return expected | Market value £000 |
| Equities | **7.1%** | **13,458** | 7.1% | 12,402 |
| Bonds | **4.6%** | **2,431** | 4.6% | 2,437 |
| Other | **5.5%** | **1,353** | 5.0% | 1,022 |
| | | **17,242** | | 15,861 |

| | 2007 | 2006 |
|---|---|---|
| **Present value of defined obligation:** | | |
| Funded plans | **(19,707)** | (20,101) |
| Total | **(19,707)** | (20,101) |
| Deficit in the scheme | **(2,465)** | (4,240) |
| Related deferred tax asset | **690** | 1,272 |
| Net pension liability | **(1,775)** | (2,968) |

# Notes to the Financial Statements continued

**22. Employee benefits continued**

**Reconciliation of opening and closing balances of the present value of the defined benefit obligation:**

| | Year ended 31 December 2007 | | Year ended 31 December 2006 | |
|---|---|---|---|---|
| | **Long-term rate of return expected** | **Market value £000** | Long-term rate of return expected | Market value £000 |
| Benefit obligation at beginning of year | | **20,101** | | 19,479 |
| Service cost | | **—** | | — |
| Interest cost | | **1,012** | | 922 |
| Actuarial (gains)/losses | | **(875)** | | 233 |
| Benefits paid | | **(531)** | | (552) |
| Past service costs | | **—** | | 19 |
| Benefit obligation at end of year | | **19,707** | | 20,101 |

**Reconciliation of opening and closing balances of the fair value of plan assets:**

| | 2007 | 2006 |
|---|---|---|
| Fair value of plan assets at beginning of year | **15,861** | 14,259 |
| Expected return on plan assets | **1,046** | 876 |
| Actuarial gain | **266** | 659 |
| Contributions by employers | **600** | 619 |
| Benefits paid | **(531)** | (552) |
| Fair value of plan assets at end of year | **17,242** | 15,861 |

**The amounts recognised in the Income Statement are:**

| | 2007 | 2006 |
|---|---|---|
| Interest on obligation | **1,012** | 922 |
| Expected return on plan assets | **(1,046)** | (876) |
| Past service cost | **—** | 19 |
| Total (gain)/expense | **(34)** | 65 |

**The (gain)/expense is recognised in the following line items in the Income Statement:**

| | Group and Company | |
|---|---|---|
| | **2007 £000** | 2006 £000 |
| Cost of sales | **—** | 19 |
| Financial income | **(1,046)** | (876) |
| Finance costs | **1,012** | 922 |
| | **(34)** | 65 |

**Actuarial gains shown in SORIE since 1 January 2004:**

| | **2007 £000** | 2006 £000 | 2005 £000 | 2004 £000 |
|---|---|---|---|---|
| Balance as at 1 January | **648** | 222 | 264 | — |
| Actuarial gains/(losses) | **1,141** | 426 | (42) | 264 |
| Balance as at 31 December | **1,789** | 648 | 222 | 264 |

History of scheme assets, obligations and experience adjustments

| | **As at 31 December 2007** | As at 31 December 2006 | As at 31 December 2005 | As at 31 December 2004 |
|---|---|---|---|---|
| Present value of defined benefit obligation | **19,707** | 20,101 | 19,479 | 18,721 |
| Fair value of scheme assets | **17,242** | 15,861 | 14,259 | 11,529 |
| Deficit in the scheme | **(2,465)** | (4,240) | (5,220) | (7,192) |
| Experience adjustments arising on scheme liabilities | **(875)** | 233 | 1,621 | 93 |
| Experience item as a percentage of scheme liabilities | **4%** | 1% | 8% | 0% |
| Experience adjustments arising on scheme assets | **266** | 659 | 1,579 | 299 |
| Experience item as a percentage of scheme assets | **2%** | 4% | 11% | 3% |

**Other pension schemes**

On 1 January 2006 a separate stakeholder scheme was set up for those employees who were originally in the closed defined benefit scheme. The contributions paid by the Company in 2007 were £527,000 (2006: £534,000).

In addition to this scheme, Zotefoams plc operates a stakeholder scheme which is open to employees who joined after 1 October 2001. The contributions paid by the Company in 2007 were £27,000 (2006: £20,000).

For US based employees Zotefoams Inc. operates a 401(k) plan. The contributions paid by Zotefoams Inc. in 2007 were $76,000 (2006: $86,000).

## 23. Share-based payments

The Company has a share option scheme that entitles senior management personnel to purchase shares in the Company. Options are exercisable at a price equal to the average quoted closing market price of the Company's shares on the previous day. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves the Group before the options vest.

In 2007 the Company introduced a LTIP scheme for senior management personnel. Shares were awarded in the Company and vest after three years to the extent performance conditions are met. Awards are forfeited if the employee leaves the Group before the award vests.

Details of the vesting conditions for the share option awards and LTIP awards are given in the Directors' Remuneration Report on page 25.

Details of the options outstanding during the year are as follows:

| | | **2007** | | 2006 |
|---|---|---|---|---|
| | **Number of share options** | **Weighted average exercise price (p)** | Number of share options | Weighted average exercise price (p) |
| Outstanding at beginning of the period | **2,268,155** | **74.9** | 3,029,219 | 76.2 |
| Forfeited during the period | **(698,186)** | **72.5** | (872,865) | 80.0 |
| Cancelled during the period | **(135,330)** | **88.7** | — | — |
| Exercised during the period | **(279,014)** | **72.5** | — | — |
| Granted during the period | **23,529** | **127.5** | 111,801 | 80.5 |
| Outstanding at the end of the period | **1,179,154** | **76.4** | 2,268,155 | 74.9 |
| Exercisable at the end of the period | **152,834** | **72.5** | — | — |

The options outstanding at 31 December 2007 have an exercise price of between 72.5p and 77.0p and a weighted contractual life of seven years.

The fair value received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of fair value of the services received was measured based on a Monte Carlo model up until 31 December 2005. From 1 January 2006 a Black-Scholes model has been used for option valuation. The contractual life of the option (ten years) is used as an input into this model. No allowance is made for early leavers.

Details of the LTIP awards outstanding during the year are as follows:

| | | **2007** | | 2006 |
|---|---|---|---|---|
| | **Number of share options** | **Weighted average exercise price (p)** | Number of share options | Weighted average exercise price (p) |
| Outstanding at beginning of the period | **—** | **—** | — | — |
| Granted during the period | **306,959** | **—** | — | — |
| Outstanding at the end of the period | **306,959** | **—** | — | — |
| Exercisable at the end of the period | **—** | **—** | — | — |

# Notes to the Financial Statements continued

### 23. Share-based payments continued

**Fair value of share options and assumptions**

The expected volatility is based on historic volatility since 1995.

| | 7 April 2004 | 22 December 2005 | **10 May 2007** |
|---|---|---|---|
| Share price (p) | 72.0 | 75.5 | **127.5** |
| Exercise price (p) | 72.5 | 77.0 | **nil** |
| Expected volatility (expressed as weighted average volatility used in modelling) | 30% | 28% | **30%** |
| Option life (expressed as weighted average life used in the modelling) | five years | five years | **five years** |
| Expected dividends (p) (assumed to be increasing at 2.5% p.a.) | 4.5 | 4.5 | **nil** |
| Risk-free interest rate (based on national government bonds) | 4.8% | 4.8% | **4.8%** |
| Fair value at grant date (p) | 15.8 | 15.8 | **127.5** |

The share option awards are granted under a service condition and a performance condition. There are no market conditions associated with the share options. The LTIP awards are granted under a service condition and a performance condition, part of which is a market condition.

The amounts recognised in the Income Statement for equity-settled share-based payments are as follows:

| | Group and Company | |
|---|---|---|
| | **2007 £000** | 2006 £000 |
| Within administrative expenses | **91** | 64 |
| Element of the above relating to Directors of Zotefoams plc | **48** | 28 |

### 24. Related parties

**Directors**

The Directors of the Company as at 3 March 2008 and their immediate relatives control 0.6% of the voting shares of the Company. Details of Directors' pay and remuneration are given in the Directors' Remuneration Report on page 24. The Directors are considered to be the only key management personnel.

**Subsidiaries**

Zotefoams plc owns 100% of the shares of Zotefoams Inc., which is incorporated in the USA. Common control exists between Zotefoams plc and Zotefoams Employee Benefit Trust (EBT) and the Zotefoams EBT has therefore been consolidated as described in note 1b. Transactions between Zotefoams plc and these subsidiaries are as follows:

**Income Statement**

| | Sales to | | Service fees to | | Interest to | | Interest from | |
|---|---|---|---|---|---|---|---|---|
| | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 |
| Zotefoams Inc. | **4,323** | 4,049 | **71** | 72 | **14** | — | **234** | 288 |

**Balance Sheet**

| | Loan owed to | | Loan owed by | | Payables owed to | | Receivables owed by | |
|---|---|---|---|---|---|---|---|---|
| | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 | **2007 £000** | 2006 £000 |
| Zotefoams Inc. | **653** | — | **3,265** | 3,321 | **—** | — | **1,655** | 879 |
| Zotefoams EBT | **—** | — | **27** | — | **27** | — | **—** | — |

*Loans with Zotefoams Inc. are interest bearing.

### 25. Accounting estimates and judgements

Management discussed with the Audit Committee the development, selection and disclosure of the Group's critical accounting policies and estimates and the application of these policies and estimates.

**Key sources of estimation uncertainty**

In note 20 detailed analysis is given of the foreign exchange exposure of the Group and risks in relation to foreign exchange movements.

Under IAS 38 development costs must be capitalised when specified criteria have been met. Following a review of the Company's research and development expenditure, because of the uncertainties which still exist on the development of new products, it was concluded that no material development costs met the IAS 38 criteria require for capitalisation and therefore all development costs have been expensed.

**Pensions assumptions**

The assumptions made on rate of return and inflation are disclosed in note 22. These have a significant impact on the value of the Scheme's liabilities. The pension scheme liability as at 31 December 2007 has been calculated using 90% of the mortality rates as set out in the standard "PA92" mortality tables, published by the Institute and Faculty of Actuaries, with allowance for improvements in member longevity in line with "Medium Cohort" projections, based on members' year of birth. These adjusted rates suggest that a man aged 65 retiring at 31 December 2007 could expect to live, on average, until age 87. A 5% change in life expectancy would increase/decrease the pension scheme's IAS 19 liability by approximately £0.7m (£0.5m after deferred tax), all other things being equal.

# Notice of 2008 Annual General Meeting

Notice is hereby given that the AGM of Zotefoams plc (the "Company") will be held at the offices of Zotefoams plc, 675 Mitcham Road, Croydon CR9 3AL on 8 May 2008 at 10am for the following purposes:

**Ordinary business**
To consider and, if thought fit, pass the following resolutions as ordinary resolutions:
1. To receive and adopt the audited accounts and the Directors' and Auditor's Report for the year ended 31 December 2007.

2. To receive and approve the Directors' Remuneration Report for the year ended 31 December 2007.

3. To declare a final dividend for the year ended 31 December 2007 of 3.0p per ordinary share, such dividend to be payable on 22 May 2008 to shareholders on the register at the close of business on 25 April 2008.

4. To re-elect R H Lawson as a Director who retires by rotation.

5. To re-elect R J Clowes as a Director having been appointed since the last AGM.

6. That KPMG Audit Plc be and are hereby re-appointed as auditor of the Company to hold office from the conclusion of this meeting until the conclusion of the next AGM at which accounts are laid before the Company and that the Directors be and are hereby authorised to fix their remuneration.

7. That the Board be and is hereby generally and unconditionally authorised to exercise all powers of the Company to allot relevant securities (within the meaning of Section 80(2) of the Companies Act 1985) of the Company up to an aggregate nominal amount of £606,710 to such persons and on such terms as it thinks fit provided that this authority shall expire on the date of the next AGM after the passing of this resolution or 15 months after the passing of this resolution (whichever shall be earlier) save that the Company may before such expiry make such an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Board may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired, such authority to be in substitution for any existing authorities conferred on the Board pursuant to Section 80 of the Companies Act 1985.

**Special business**
To consider and, if thought fit, to pass the following resolutions of which resolution 10 will be proposed as an ordinary resolution and resolutions (8 and 9) will be proposed as special resolutions:
8. That subject to the passing of resolution 7 the Board be and is hereby empowered pursuant to Section 95 of the Companies Act 1985 to allot equity securities (within the meaning of Section 94(2) to Section 94 (3A) of the said Act) for cash pursuant to the authority conferred by the previous resolution as if Section 89(1) of the said Act did not apply to any such allotment provided that this power shall be limited:
   (a) to the allotment of equity securities in connection with an issue in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as maybe) to the respective numbers of ordinary shares held by them subject only to such exclusions or other arrangements as the Directors may consider appropriate to deal with fractional entitlements or legal or practical difficulties under the laws, rules or regulations of any jurisdiction, stock exchange or other regulatory body whatsoever; and
   (b) to the allotment (otherwise than pursuant to sub-paragraph (a) above) for cash of equity securities up to an aggregate nominal value of £91,006, and shall expire on the date of the next AGM of the Company after the passing of this resolution or 15 months after the passing of this resolution (whichever shall be earlier) save that the Company may before expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Board may allot equity securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired, such authority to be in substitution for any existing authorities conferred on the Board pursuant to Section 95 of the Companies Act 1985. This power applies in relation to a sale of shares which is an allotment of equity securities by virtue of Section 94 (3A) of the said Act as if the words "pursuant to the authority conferred by the previous resolution" were omitted.

9. That the Company be and is hereby generally and unconditionally authorised for the purposes of Section 166 of the Companies Act 1985 to make one or more market purchases (within the meaning of Section 163(3) of the said Act) on the London Stock Exchange plc of ordinary shares of 5p each in the capital of the Company provided that:
   (a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 3,640,260 (representing 10% of the Company's issued ordinary share capital);
   (b) the minimum price which may be paid for such shares is 5p per share (exclusive of any applicable taxes and expenses);
   (c) the maximum price (exclusive of any applicable taxes and expenses) which may be paid for an ordinary share shall not be more than 5% above the average of the market values for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the date on which the ordinary share is purchased;
   (d) unless previously renewed, varied or revoked, the authority hereby conferred shall expire at the conclusion of the Company's next AGM or 15 months from the date of passing this resolution, if earlier; and
   (e) the Company may make a contract or contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make a purchase of ordinary shares in pursuance of any such contract or contracts.

# Notice of 2008 Annual General Meeting continued

10.That the Zotefoams plc 2008 Approved Share Option Plan (the main features of which are summarised in the letter to shareholders dated 18 March 2008) and a copy of the draft rules of which are produced to this meeting and signed by the Chairman for the purpose of identification, be and is hereby approved and adopted and the Directors be and are hereby authorised to do all such acts and things as they may consider necessary or expedient for the purposes of carrying the same into effect.

By order of the Board

**CG Hurst**
Company Secretary
Zotefoams plc

**Registered office**
675 Mitcham Road
Croydon CR9 3AL

18 March 2008

**Notes**

(i) Shareholders are entitled to attend and vote at this meeting and may appoint one or more proxies to attend and on a poll, vote instead of him. A proxy need not be a member of the Company. A form of proxy is enclosed for the use of members and must reach the office of the Registrars of the Company not less than 48 hours prior to the start of the meeting. If you are not a member of the Company but you have been nominated by a member of the Company to enjoy information rights, you do not have a right to appoint any proxies under the procedures set out in this note. Please read note (vii) below.

(ii) The appointment of a proxy will not prevent the member from subsequently attending and voting at the meeting in person.

(iii) Copies of the following will be available for inspection at the registered office of the Company, 675 Mitcham Road, Croydon CR9 3AL during normal business hours from the date of the above notice until the date of the AGM and at the place of the meeting for 15 minutes prior to and until the termination of the Meeting:
  (a) the register of Directors' share interests; and
  (b) copies of Directors' service contracts; and
  (c) copies of Directors' Deeds of Indemnity; and
  (d) Letters of Appointment for Non-Executive Directors.

(iv) Only those members registered in the register of members of the Company as at 10am on 6 May 2008 will be entitled to attend or vote at the meeting in respect of the number of ordinary shares of 5p registered in their respective names at that time. Changes to entries on the register after 10am on 6 May 2008 will be disregarded in determining the rights of any person to attend or vote at the meeting.

(v) Copies of the rules of the Zotefoams plc 2008 Approved Share Option Plan are available for inspection during the business hours at the registered office of the Company and at MM & K Ltd, 1 Bengal Court, Birchin Lane, London EC3V 9DD on Mondays to Fridays (public holidays excluded) from the date of this Notice and at the place of the AGM from 9.45am on the day of the meeting until the conclusion of the AGM.

(vi) As at 10am on 18 March 2008, the Company's issued share capital comprised 36,862,401 ordinary shares of 5p each. Each ordinary share carries the right to one vote at a general meeting of the Company and, therefore, the total number of voting rights in the Company as at 10am on 18 March 2008 is 36,862,401.

(vii) If you are a person who has been nominated under section 146 of the Companies Act 2006 to enjoy information rights (a "Nominated Person") you may have a right under an agreement between you and the member of the Company who has nominated you to have information rights (the "Relevant Member") to be appointed or to have someone else appointed as a proxy for the Meeting. If you either do not have such a right or if you have such a right but do not wish to exercise it, you may have a right under an agreement between you and the Relevant Member to give instructions to the Relevant Member as to the exercise of voting rights. Your main point of contact in terms of your investment in the Company remains the Relevant Member (or, perhaps, your custodian or broker) and you should continue to contact them (and not the Company) regarding any changes or queries relating to your personal details and your interest in the Company (including any administrative matters). The only exception to this is where the Company expressly requests a response from you.

# Five Year Trading Summary

| | **IFRS 2007 £m** | IFRS 2006 £m | IFRS 2005 £m | IFRS 2004 £m | UK GAAP 2003 £m |
|---|---|---|---|---|---|
| Turnover | **31.6** | 30.1 | 28.0 | 25.2 | 23.5 |
| Operating profit (excluding exceptional items) | **3.5** | 2.8 | 2.0 | 1.6 | 1.1 |
| Profit before tax (excluding exceptional items) | **3.4** | 2.7 | 1.8 | 1.3 | 1.0 |
| Profit before tax (including exceptional items) | **3.4** | 1.6 | 3.3 | 1.3 | 1.0 |
| Profit after tax | **2.9** | 1.2 | 2.4 | 1.2 | 0.7 |
| Capital expenditure | **2.7** | 2.6 | 1.1 | 1.3 | 1.6 |
| Cash generated from the operations | **4.8** | 4.7 | 4.1 | 5.3 | 3.5 |
| Dividends per ordinary share (p) | **4.5** | 4.5 | 4.5 | 4.5 | 4.5 |
| Basic earnings per share excluding exceptional items (p) | **8.0** | 5.4 | 3.5 | 3.2 | 2.0 |
| Basic earnings per share including exceptional items (p) | **8.0** | 3.4 | 6.7 | 3.2 | 2.0 |

The amounts disclosed for 2003 is stated on the basis of UK GAAP because it is not practicable to restate amounts prior to the date of transition to IFRS.

The principal differences which arose when the Group converted to IFRS from UK GAAP for 2004 were in the following areas:

- dividend recognition
- deferred taxation
- pensions
- share-based payments and
- foreign currency and financial instruments.

# Financial Calendar

| | |
|---|---|
| AGM | 8 May 2008 |
| Payment of final dividend | 22 May 2008 to shareholders on the register at the close of business on 25 April 2008 |
| Announcement of 2008 interim results | August 2008 |
| Payment of interim dividend | September 2008 |
| Announcement of 2008 results | March 2009 |

**Registrars**
Enquiries concerning the holding of ordinary shares in the Company should be addressed to the registrars who should also be notified of any changes in a holder's address.

The registrars are: Computershare Investor Services Plc, PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH.

**Website**
The Company has a website (www.zotefoams.com) which provides information on the business and products.

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T-Tubes® is a registered trademark of UFP Technologies Inc.
Kynar® is a registered trademark of Arkema Inc.

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by ckd
www.ckdcorp.co.uk

Printed by
Spin Offset
www.spinoffset.co.uk

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