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ZOO Digital Group plc

Report and financial statements

31 March 2006

Registered number: 3858881



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Year in brief

Financial Highlights

- Group turnover £9.16m (2005: £12.67m – 15 month period)
- Loss before Interest, Tax, Depreciation and Amortisation £3.37m (2005: £1.59m – 15 month period)
- Retained Loss after loss on disposal of discontinued operations and goodwill amortisation £8.25m (2005: £2.23m – 15 month period)
- Group restructured with closure of computer games division
- Share placing and Loan note issue raising £4.2m gross announced
- ZOOtech signs first major contract for Menu Regionalisation product
- ZOOtech revenues up 322% to £1.9m (2005: £0.45m – 15 month period) with over 80 customers in 11 countries
- 15 patents granted and 62 patents applied for

Company information

Directors	Dr Christopher H B Honeyborne (Chairman) Dr Stuart A Green (Chief Executive Officer) Robert G Deri (Chief Financial Officer) Andrew Scrivener (Chief Operating Officer) Ian C Stewart (Non-Executive Director)
Company Secretary	Robert G Deri
Registered Office	20 Furnival Street, Sheffield, S1 4QT
Website Address	www.zoodigitalgroup.com
Nominated Adviser	Noble & Company Limited 76 George Street Edinburgh EH2 3BU
Nominated Broker	Noble & Company Limited 5 th Floor 120 Old Broad Street London EC2N 1AR
Auditors	PKF (UK) LLP Knowle House 4 Norfolk Park Road Sheffield S2 3QE
Solicitors to the Company	DLA Piper UK LLP 1 St Paul's Place Sheffield S1 2JX
Bankers	Bank of Scotland 7 Leopold Street Sheffield S1 2FF
Registrars	Capita Registrars The Registry 34 Beckenham Road Beckenham Kent BR3 4TU

CHAIRMAN'S STATEMENT

The Financial Year 2005/06 presented ZOO with a number of challenges which resulted in the Group making fundamental changes under a comprehensive strategic review. As part of this review Dr Stuart Green, previously Chief Technology Officer and the driving force behind the ZOOtech division, was appointed CEO with Ian Stewart stepping down and becoming a Non-Executive Director. The strategic review has led the company to focus its resources and capability on its core technology business of developing and licensing unique productivity solutions for DVD and video post production; a business characterized by high margins and outstanding opportunities for growth.

In 'ZOOtech', the R&D and software licensing division, our DVD development system DVD-EXTRA STUDIO is now proven as the leading solution for interactive DVD title production and the associated revenues have increased significantly during the year. A new product – the Regionalization Tool – has provided the first entry for ZOO into the lucrative video post production market and our Hollywood based customers are now enjoying the benefits of significantly reduced costs and accelerated time to market of regionalized DVD titles. ZOO's DVD production division 'ZOO Interactive Video' ("ZIV") has produced some of the best performing interactive DVD titles in 2005 and received a number of industry awards for product excellence and retail performance.

As part of a strategic review following an increasingly difficult computer games market, the Group decided to close its traditional games publishing arm ZOO Digital Publishing and sold the remaining assets for a cash consideration of £250,000. ZOO's business now focuses solely on the development and licensing of DVD and video production software, and the creation and publication of interactive DVD-Video ("iDVD") titles.

In August we announced a fundraising of £4.2m gross which will underpin the Group's business plan and provide working capital to take the Group forward and move into profit. We believe that prospects for the Group under its new structure and focus are sound and look forward to a period of growth as we capitalise on our range of innovative software products.

Christopher Honeyborne, Chairman

CHIEF EXECUTIVE'S REVIEW

From an operational point of view, the year to March 2006 saw ZOOtech gain significant traction in the market across eleven countries with a number of blue chip customers; and ZOO Interactive Video established as one of the leading producers of interactive DVD titles. The well-documented difficulties in the computer games market had a profound effect on our Games Publishing division, which became apparent over the Christmas period. After careful consideration of market conditions, the Board concluded that the risks associated with this non-core part of the business had increased following the Christmas trading period and took the decision to close it.

We believe that the restructuring of the business allows investors to appreciate fully the value we have in our DVD-EXTRA software and the potential for growth driven by our patented technology. We have reduced our operating costs significantly and now have 67 full time employees compared with 115 in January 2006.

Financial Review

Following the trading update announced on 23 January 2006, turnover for the twelve month period to 31 March 2006 fell to £9.16 million (2005: £12.67 million – 15 month period). Loss before interest, tax, depreciation and amortisation was £3.37 million (2005: £1.59 million – 15 month period), which largely resulted from the decision not to publish games from the Group's now redundant games publishing business in the final quarter and disappointing revenues from own developed games. An exceptional one off loss on disposal of £2.74 million (2005: nil) and an exceptional goodwill amortisation of £0.96 million (2005: nil) were incurred from this restructuring.

Chairman and Chief Executive's statement

As at 31 March 2006 the Group had net assets of £1.93 million (2005: £6.94 million) with a bank overdraft of £317,000. Part of the fundraising will be used to repay the Group's debt position and provide sufficient working capital.

ZOOtech Ltd

The past 12 months have been a period of rapid growth for ZOOtech, during which revenues increased to £1.9 million from £452,000 in the 15 month period to 31 March 2005. Following the successful launch of the DVD development system DVD-EXTRA STUDIO, the Group introduced a second product focusing on 'regionalization' which enables DVD publishers to produce versions of their titles for multiple languages more quickly and less expensively. Following extensive trials, the system has now been in use for around seven months in the production of mainstream DVD-Video titles in Hollywood.

The Regionalization Tool represents ZOOtech's first offering for conventional DVD production and marks its entry into the video post production market. The Board believes that the post production market, especially in North America, represents a significant opportunity and the Group has therefore placed a greater emphasis on commercial operations in this territory.

We continue to pursue our intellectual property programme and protect our innovations through the filing of patents in multiple territories. Our portfolio has reached over 60 applications across 21 patent families, of which 14 have been granted in the UK and one in New Zealand.

ZOOtech, its products and several third party DVD-EXTRA titles have been the recipients of a number of prestigious awards. ZOOtech was one of 20 winners of the European IST Prize – the most distinguished prize for innovative products and services in the field of Information Society Technologies. In March 2006, at the DVD Association's annual DVD Excellence Awards ceremony, a total of eight awards were given to products created with DVD-EXTRA STUDIO. ZOOtech was awarded a DTI grant for R&D to the value of £200,000 for research and development of its Templated Authoring System.

The market focus of ZOOtech now lies in two distinct areas: the video post production market into which we provide productivity tools, and the interactive DVD market for which ZOOtech licenses the only product available designed specifically for interactive DVD title development. The Company's strategy is to develop unique, innovative technology products based upon patented methods that can be used to enable video content owners and their vendors to simplify the creation of titles for multiple territories across multiple platforms.

Video Post Production

Video post production is a well established industry within which annual spend is considerable. ZOOtech's aim within this industry is to provide technologies that simplify the creation of video products for multiple platforms and territories and is developing a suite of application programs for this purpose. ZOOtech's first such product, the Regionalization Tool, and the forthcoming Templated Authoring System both automate a considerable proportion of work that has traditionally been performed manually, usually by post production facilities on behalf of studios and other DVD publishers. These tools are attractive to content owners because they can dramatically cut the cost of producing each new DVD title since they significantly reduce labour related to production. Importantly, there are no other commercial products available with this capability.

During the last year we launched the Regionalization Tool and announced our first major contract with a Hollywood studio. The product has now been independently benchmarked by a number of organizations, with measured productivity improvements of 75% or more. In some cases this can equate to savings for our customers of multiple millions of dollars annually. We have recently licensed the Regionalization Tool to Elektrofilm, a global digital media services facility with studios in Los Angeles, Berlin, Cologne, Leipzig, Munich, Potsdam and Stuttgart, who will use the system as part of its high-end DVD production services offered to Hollywood studios and other publishers and we expect other organizations to take up the product.

Chairman and Chief Executive's statement

The Templated Authoring System which automates the preparation of video content for titles on multiple platforms and in multiple territories is due for release in the autumn. The initial version of the Templated Authoring System is designed for production of DVD-Video titles, but we are already exploring opportunities for other video delivery platforms, including next generation optical discs and TV deployment.

While we remain focused in our product development and commercialization efforts to secure revenues in the short to medium term, we continue to identify significant opportunities for new product development in the future, which will provide incremental revenue streams.

Interactive DVD

The interactive DVD market in the UK, pioneered by ZOO, has demonstrated significant growth in the past year. Around 30 titles in the category were introduced prompting retailers including HMV, Virgin, WHSmith and Borders to dedicate in-store shelf space to the genre for the first time. Collectively, interactive DVD titles sold around 3 million units over the Christmas 2005 period, of which we estimate around 70% were produced using DVD-EXTRA STUDIO.

According to data reported in the British Video Association (BVA) Yearbook 2006, interactive DVDs were responsible for a significant market share gain of the "special interest" genre, up from 2.3% of volume in 2004 to 3.8% in 2005. Of the top 20 special interest titles, 17 were interactive DVDs and of these 13 were created using DVD-EXTRA STUDIO. These titles were hugely popular over Christmas 2005 and companies produced a whole range of products to meet demand, growing the sub-genre by 100% in the year. The best seller in the special interest category was "Who Wants to be a Millionaire? 3" developed by ZOO Interactive Video and published by Universal with 344,000 units sold, making it the 14th best selling UK DVD overall in December 2005. In the first half of 2006 this product has sold through a further 71,000 units bringing its total volume sales to 415,000.

A particularly impressive performance was shown by the title "Now That's What I Call a Music Quiz" published by EMI/Universal, selling over 410,000 units in December 2005 and making this title the best seller in the "music" category for the year demonstrating the significant revenue and profit potential of interactive DVD to music publishers.

The UK interactive DVD market is showing further significant growth in 2006 in terms of the number of new titles in development. We expect there to be over a hundred titles available over the Christmas period of which we estimate around half will be created using DVD-EXTRA STUDIO.

New licensees are being added on an on-going basis; in North America new agreements with Scholastic Media, Brighter Minds Media and Endless Games for products that use ZOOtech's technology for new interactive DVDs will produce a broad range of new titles based on popular television, film and book properties. In Europe, further licenses have been agreed with Vivid Imaginations Ltd, Big Red Frog, Silenn and Compedia. ZOOtech has also signed its first developer and publisher contracts in Italy with Cinehollywood, demonstrating the continued expansion and growth in the market for interactive DVDs across multiple territories. These additions contribute to a robust publishing schedule for 2006 and 2007 across a number of DVD game categories.

ZOO Interactive Video Ltd ("ZIV")

ZIV is focused on the development of interactive DVD titles and partners with publishers to provide the channel for its products in the market. ZIV's efforts have been responsible for the establishment of the interactive DVD category at retail, with dedicated point-of-sale areas appearing for the first time in December 2005. In the year four new titles were developed by ZIV: "Who Wants to be a Millionaire? 3", "Wallace & Gromit DVD Game", "Telly Addicts" and "Interactive Championship Challenge 2", which were published by Universal Pictures across eight territories including UK, France, Germany and Japan.

Chairman and Chief Executive's statement

At the DVD Association Excellence Awards held in May 2006, ZIV received six awards including two for technical achievement and one for children's DVD excellence. The British Video Association presented ZIV with three Retail Performance Awards for "Who Wants to be a Millionaire? 3", "Telly Addicts" and "Wallace & Gromit DVD Game"

ZIV is increasing its' output for Christmas 2006 to seven titles which will be published by Universal Pictures and 2 Entertain Ltd. ZIV's strategy is to grow the interactive DVD market through the development of premium branded titles for trivia as well as non-quiz genres, and its products rank amongst the most sophisticated in the market.

Outlook

The Board has taken decisive measures to focus the business as a technology company. It is clear that we have unique technologies supported by patents and following the successful completion of the proposed fundraising, the Board remains confident about the prospects for the Group.

We believe that ZOO offers an attractive opportunity for investors and expect the interactive DVD market to grow across a number of territories in the coming year with revenues increasing accordingly. We believe that revenues generated by our video post production tools will increase significantly as we further deploy installations of the Regionalization Tool and introduce the Templated Authoring System into the market.

The Group has clear objectives and an effective platform for growth and the business continues to attract new customers as well as developing relationships with key multi-national companies. Our future product development plans are well defined and are being driven by customer requirements. We expect ZOO's technology to play an increasingly important role in the video post production market.

We anticipate that the restructured group will provide a sound base for the business. The fundraising allows the Group to eliminate debt completely and provide working capital to take the business forward.

I would like to take the opportunity to express the Board's deep gratitude to all our employees for their unstinting dedication and enormous contribution during the year.

Stuart Green, CEO



ZOO Digital Group plc

28 September 2006

Directors' Report

The directors present their report on the affairs of the group, together with the financial statements and auditors' report, for the year ended 31 March 2006.

Principal activities

The principal activity of the group for the year under review was the research and development of interactive DVD technology and the publishing of games and entertainment products for digital platforms.

Business review

A review of the development of the business together with an indication of future developments is included in the Chairman and Chief Executive's statement set out on pages 3 to 6.

Results and dividends

The audited financial statements for the year ended 31 March 2006 are set out on pages 14 to 40. The directors do not recommend the payment of a dividend for the year.

Directors

The directors who served during the year were as follows:

Name	Position	
M John Barnes	Non-Executive Chairman	Resigned 27 September 2006
Dr Christopher H B Honeyborne	Non-Executive Chairman	
Dr Stuart A Green	Chief Executive Officer	
Robert G Deri	Chief Financial Officer	
Andrew Scrivener	Chief Operating Officer	
Ian C Stewart	Non-Executive Director	

Details of the interests in the shares of the company at the beginning (or subsequent date of appointment) and end of the financial year of those directors who held office at 31 March 2006 are disclosed in note 7. In accordance with the company's Articles of Association Stuart Green and Christopher Honeyborne retire by rotation at the next Annual General Meeting and, being eligible, offer themselves for re-election.

Directors' Report

Dr Christopher H B Honeyborne – Non-Executive Chairman (aged 65)

Dr Honeyborne spent 24 years in investment banking, gaining experience in a variety of senior roles with Lazard Brothers, Banque Paribas Group and Bank of N.T. Butterfield & Son. Since then, Dr Honeyborne has held a number of high-profile non-executive directorships, including Yorkshire Water plc, Birse Group plc and Gremlin Group plc and is now Non-Executive Chairman of Dyson Group plc and a Non-Executive Director of Bede plc, as well as of a number of unquoted companies.

Christopher has been a non-executive director since 2000 and became Chairman on 27 September 2006.

Dr Stuart A Green – Chief Executive Officer (aged 41)

Stuart brings more than 15 years of experience of team building and executive management in the software industry to his role as CEO. Prior to his appointment as CEO Stuart was CTO, where he was responsible for determining the technology strategy and expanding the core intellectual property of the company. Previously he founded Kazoo3D plc and prior to that was co-founder of LightWork Design Limited where he served as Technical Director with responsibility for implementing LightWork Design Limited's technical development strategy. Stuart received a Ph.D. in Computer Science from the University of Bristol in 1989 for his research into computer systems for advanced computer graphics. He has 15 issued and almost 60 patents pending in the fields of image processing and DVD authoring.

Robert Deri – Chief Financial Officer and Company Secretary (aged 43)

Robert was appointed in May 2001 and previously worked for Grattan plc as Group Finance Director. Prior to that, he held senior positions at BT Mobile, Colorvision plc and The Burton Group plc. Robert qualified as a Chartered Accountant with KPMG in 1987.

Andrew Scrivener – Chief Operating Officer (aged 47)

Andrew was the Managing Director of The ZOO Media Corporation Limited. He was previously Technical Director at Sears plc and was responsible for retail design, surveying, engineering and procurement across 15 brands in European and Middle Eastern territories.

Directors' Report

Ian Stewart – Non-Executive Director (aged 53)

Ian founded Gremlin Interactive Limited, a developer and publisher of computer games for consumers, in 1984. He grew that company through organic growth and strategic acquisition until July 1997 when it floated on the London Stock Exchange as Gremlin Group plc. Infogrames SA acquired Gremlin Group plc for £25 million in May 1999 and Ian founded The ZOO Media Corporation Limited in October 1999.

Ian was Chief Executive Officer until February 2006 when he stepped down to become a non-executive director.

Supplier payment policy

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the company at 31 March 2006 were equivalent to 40 days' (2005: 42 days) purchases, based on the average daily amount invoiced by suppliers during the year.

Charitable and political contributions

During the year the group made no charitable or political donations.

Substantial shareholdings

On 31 August 2006, the company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests in the ordinary share capital of the company:

Name of holder	Number	Percentage held
Mr I C Stewart	61,037,155	19.2%
Herald Investment Trust plc	22,900,000	7.2%
F&C Asset Management	15,285,572	4.8%
Dr S A Green	9,641,500	3.0%
Mr W Newell	9,380,500	3.0%
Artemis AIM VCT Trust plc	9,350,000	3.0%

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. 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 with that of other employees.

Directors' Report

Employee consultation

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through formal and informal meetings. All full-time employees, following the successful completion of their probation become entitled to share options in the company.

Disclosure of information to auditors

So far as each of the directors is aware at the time the report is approved:

- there is no relevant information of which the company's auditors are unaware, and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

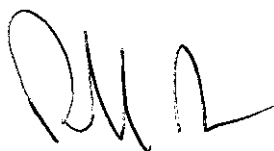
Financial instruments

The company does not actively use financial instruments as part of its financial risk management. It is exposed to the usual credit risk and cash flow risk associated with selling on credit and manages this through credit control procedures. The nature of its financial instruments means that they are not subject to price risk or liquidity risk.

Auditors

A resolution for the reappointment of PKF (UK) LLP will be proposed at the forthcoming annual general meeting.

By Order of the Board



Robert Deri

Director and Secretary

20 Farnival Street
Sheffield
South Yorkshire
S1 4QT

28 September 2006

Statement of Directors' responsibilities

Financial statements

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

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

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

Other matters

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

Independent Auditors' report

To the members of ZOO Digital Group plc

We have audited the group and parent company financial statements ("the financial statements") of ZOO Digital Group plc for the year ended 31 March 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' 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 and the financial statements in accordance with applicable law and United Kingdom Accounting Standards ("United Kingdom Generally Accepted Accounting Practice") are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements 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 have been properly prepared in accordance with the Companies Act 1985. 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 read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises only the Company information, Chairman and Chief Executive's statement, Directors' report and Statement of Directors' Responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies within the financial statements. Our responsibilities do not extend to any other information.

We report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information in the Directors' report includes that specific information presented in the Chairman and Chief Executive's statement that is cross-referenced from the business review section of the Directors' report.

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. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements and of whether the accounting

Independent Auditors' report

policies are appropriate to the circumstances of the company and of the group, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice of the state of the group's and the parent company's affairs as at 31 March 2006 and of the group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the financial statements.

PKF(UK)LLP

PKF (UK) LLP

Registered Auditors

Sheffield, UK

28 September 2006

Consolidated profit and loss account
For the year ended 31 March 2006

	Notes	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Turnover			
Continuing operations		3,940	3,702
Discontinued operations		5,224	8,967
	2	<u>9,164</u>	<u>12,669</u>
Cost of sales	1	(6,183)	(7,611)
Gross profit		<u>2,981</u>	<u>5,058</u>
Other operating income		20	260
Other operating expenses	5		
- other		(6,373)	(6,907)
Loss before interest, tax, depreciation and amortisation		<u>(3,372)</u>	<u>(1,589)</u>
- depreciation		(173)	(155)
- amortisation of intangible fixed assets		(682)	(593)
		<u>(7,228)</u>	<u>(7,655)</u>
Operating loss			
Continuing operations		(2,777)	(1,737)
Discontinued operations		(1,450)	(600)
		<u>(4,227)</u>	<u>(2,337)</u>
Loss on disposal of discontinued operation	5	(3,698)	-
Other interest receivable and similar income	3	25	99
Amounts written off investment	24	(240)	-
Interest payable and similar charges	4	(109)	(42)
Loss on ordinary activities before taxation	5	<u>(8,249)</u>	<u>(2,280)</u>
Tax on loss on ordinary activities	8	-	53
Retained loss for the financial year	22	<u>(8,249)</u>	<u>(2,227)</u>
Loss per share			
Basic	11	(2.67p)	(0.80p)
Diluted	11	<u>(2.67p)</u>	<u>(0.80p)</u>
Loss per share – continuing operations			
Basic	11	(1.00p)	(0.58p)
Diluted	11	<u>(1.00p)</u>	<u>(0.58p)</u>

There were no recognised gains or losses for the year other than those included in the profit and loss account.

The accompanying notes are an integral part of this consolidated profit and loss account.

Consolidated balance sheet
31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Fixed assets			
Intangible assets	12	2,007	3,351
Tangible assets	13	342	377
		<u>2,349</u>	<u>3,728</u>
Current assets			
Stock	15	48	903
Debtors	16	2,499	5,937
		<u>2,547</u>	<u>6,840</u>
Creditors: Amounts falling due within one year	17	(2,962)	(3,630)
Net current (liabilities) / assets		<u>(415)</u>	<u>3,210</u>
Total assets less current liabilities		<u>1,934</u>	<u>6,938</u>
Net assets		<u>1,934</u>	<u>6,938</u>
Capital and reserves			
Called-up share capital	21	635	559
Share premium account	22	21,648	18,719
Other reserves	22	8,598	8,598
Profit and loss account	22	(28,858)	(20,609)
Shareholders' funds (all equity)	23	<u>2,023</u>	<u>7,267</u>
Interest in own shares	24	(89)	(329)
		<u>1,934</u>	<u>6,938</u>

The financial statements of pages 14 to 40 were approved and authorised for issue by the board of directors on 28 September 2006 and signed on its behalf by:



Stuart A Green

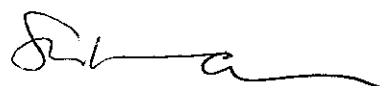
The accompanying notes are an integral part of this consolidated balance sheet.

Company balance sheet

31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Fixed assets			
Intangible assets	12	1,595	1,947
Tangible assets	13	145	180
Investments	14	6,785	7,947
		<u>8,525</u>	<u>10,074</u>
Current assets			
Debtors	16	4,787	5,722
Cash at bank and in hand		13	23
		<u>4,800</u>	<u>5,745</u>
Creditors: Amounts falling due within one year	17	(637)	(487)
Net current assets		<u>4,163</u>	<u>5,258</u>
Total assets less current liabilities		12,688	15,332
Creditors: Amounts falling due after more than one year	18	(6,785)	(6,785)
		<u>5,903</u>	<u>8,547</u>
Capital and reserves			
Called-up share capital	21	635	559
Share premium account	22	21,648	18,719
Other reserves	22	7,394	7,394
Profit and loss account	22	(23,685)	(17,796)
Shareholders' funds (all equity)		<u>5,992</u>	<u>8,876</u>
Interest in own shares	24	(89)	(329)
		<u>5,903</u>	<u>8,547</u>

The financial statements on pages 14 to 40 were approved and authorised for issue by the board of directors on 28 September 2006 and signed on its behalf by:



Stuart A Green

The accompanying notes are an integral part of this balance sheet.

Consolidated cash flow statement

For the year ended 31 March 2006

	Notes	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Net cash outflow from operating activities	25	(2,004)	(4,302)
Exceptional items	30	(35)	-
Returns on investments and servicing of finance	26	(84)	57
Capital expenditure and financial investment	27	(470)	(1,107)
Cash outflow before financing		<u>(2,593)</u>	<u>(5,352)</u>
Financing	28	<u>3,005</u>	<u>(828)</u>
Increase/(decrease) in cash in the year		<u>412</u>	<u>(6,180)</u>
Reconciliation of net cash flow to movement in net (debt)/funds (Note 29)			
	Notes	2006 £'000	2005 £'000
Increase/(decrease) in cash in year		412	(6,180)
Cash outflow from decrease in debt and lease financing		<u>-</u>	<u>858</u>
Change in net (debt)/funds resulting from cash flows		<u>412</u>	<u>(5,322)</u>
Net (debt)/funds at 1 April 2005		<u>(729)</u>	<u>4,593</u>
Net debt at 31 March 2006	29	<u>(317)</u>	<u>(729)</u>

The accompanying notes are an integral part of this consolidated cash flow statement.

Statement of accounting policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year.

Basis of accounting

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

Basis of preparation

The consolidated financial statements incorporate the financial statements of the company and its' subsidiary undertakings, which are drawn up to 31 March 2006. In accordance with the exemption given under Section 230 of the Companies Act 1985 the company has not presented its own profit and loss account.

Intangible assets – goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is 10 years. Provision is made for any impairment. Following a provision for impairment the original cost less the impairment provision is written off over the remaining useful economic life of the asset.

Intangible assets – patent costs

Patent costs are stated at cost, net of amortisation and any provision for impairment. Amortisation is charged on a straight line basis over the useful economic life of the assets, which is 10 years.

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all such fixed assets at rates calculated to write off the cost of each asset less estimated residual value, on a straight-line basis, over its expected useful life, as follows:

Leasehold improvements	5 years
Computers	between 2 and 3 years
Office equipment, fixtures and fittings	between 2 and 5 years

Statement of accounting policies

Investments

Except as stated below, fixed asset investments are shown at cost less provision for impairment.

In the company balance sheet, for investments in subsidiaries acquired for consideration including the issue of shares, cost is measured by reference to the market value of the shares on the date of the transaction.

Research and development

Research and development expenditure is charged to the profit and loss account in the period in which it is incurred. Development costs that relate to clearly defined projects which are technically feasible and commercially viable, are capitalised and amortised on a straight line basis over 3 years provided that recoverability can be assessed with reasonable certainty.

Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

As required by FRS 19 "Deferred Tax", full provision is made for deferred tax assets and liabilities arising from all timing differences between the recognition of gains and losses in the financial statements and recognition in the tax computation, except for those timing differences in respect of which the standard specifies that deferred tax should not be recognised.

Turnover

Turnover represents royalty income and other sales at invoice value less trade discounts allowed and excluding VAT.

Royalties receivable on products released prior to the period-end are credited to the profit and loss account when due.

Guaranteed royalties falling due under contracts for products under development at the period-end are credited to the profit and loss account to the extent that the company's contractual obligations have been fulfilled and attributable product development costs incurred are charged in the same period.

Statement of accounting policies

Pension costs and other post retirement benefits

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the period. Differences between contributions payable in the period and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Foreign currency

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date.

Operating leases

Rentals under operating leases are charged to the profit and loss account on a straight-line basis over the lease term.

Stocks and work in progress

Stocks and work in progress are stated at the lower of cost and net realisable value. Cost includes all direct costs incurred and attributable production overheads. Net realisable value is based on estimated selling price allowing for all further costs of completion and disposal.

Product development expenditure is carried forward to the extent that it is considered to be recoverable. The amount carried forward is written off on release over the expected sales life of each product.

Government grants

Government grants in respect of capital expenditure are treated as deferred credits, a proportion of which is transferred to revenue annually over the life of the asset. Government grants in respect of revenue expenditure are recognised in the profit and loss account so as to match them with the expenditure towards which they are intended to contribute.

Notes to financial statements

1. Discontinued Activities

	2006			2005		
	Continuing £'000	Discontinued £'000	Total £'000	Continuing £'000	Discontinued £'000	Total £'000
Cost of sales	<u>1,935</u>	<u>4,248</u>	<u>6,183</u>	<u>1,399</u>	<u>6,212</u>	<u>7,611</u>
Other operating expenses	4,803	2,425	7,228	4,297	3,358	7,655
Other operating income	<u>(20)</u>	<u>-</u>	<u>(20)</u>	<u>(260)</u>	<u>-</u>	<u>(260)</u>
	<u>4,783</u>	<u>2,425</u>	<u>7,208</u>	<u>4,037</u>	<u>3,358</u>	<u>7,395</u>

The discontinued activity relates to the disposal of the games publishing element of the Games Production and Distribution Division.

2. Segment information

Divisional:

	Holding Company £'000	Games Production and Distribution £'000	DVD Technology £'000	Total £'000
Turnover				
31 March 2006				
Gross turnover	-	7,468	1,913	9,381
Inter company sales	-	-	(217)	(217)
	<u>-</u>	<u>7,468</u>	<u>1,696</u>	<u>9,164</u>
31 March 2005				
Gross turnover	1	12,286	452	12,739
Inter company sales	-	-	(70)	(70)
	<u>1</u>	<u>12,286</u>	<u>382</u>	<u>12,669</u>

Notes to financial statements

2. Segment information (continued)

	Holding Company £'000	Games Production and Distribution £'000	DVD Technology £'000	Total £'000
Operating profit/(loss)				
31 March 2006	<u>(1,899)</u>	<u>(1,522)</u>	<u>(806)</u>	<u>(4,227)</u>
31 March 2005	<u>(640)</u>	<u>436</u>	<u>(2,133)</u>	<u>(2,337)</u>
Net assets				
31 March 2006	<u>10,013</u>	<u>(4,449)</u>	<u>(3,630)</u>	<u>1,934</u>
31 March 2005	<u>8,182</u>	<u>835</u>	<u>(2,079)</u>	<u>6,938</u>
Geographical:				
	United Kingdom £'000	Europe £'000	Other £'000	Total £'000
Turnover (by destination)				
31 March 2006	<u>3,720</u>	<u>2,762</u>	<u>2,682</u>	<u>9,164</u>
31 March 2005	<u>7,618</u>	<u>4,489</u>	<u>562</u>	<u>12,669</u>
Operating profit/(loss)				
31 March 2006	<u>(4,807)</u>	<u>172</u>	<u>407</u>	<u>(4,227)</u>
31 March 2005	<u>(4,019)</u>	<u>1,679</u>	<u>3</u>	<u>(2,337)</u>
Net assets				
31 March 2006	<u>1,934</u>	<u>-</u>	<u>-</u>	<u>1,934</u>
31 March 2005	<u>6,938</u>	<u>-</u>	<u>-</u>	<u>6,938</u>

The turnover for the year is generated entirely from the UK.

Notes to financial statements

3. Other interest receivable and similar income

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Bank interest	<u>25</u>	<u>99</u>

4. Interest payable and similar charges

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Finance leases and hire purchase contracts	-	(1)
Bank interest	(109)	(26)
Other loans	-	(15)
	<u>(109)</u>	<u>(42)</u>

5. Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging/(crediting):

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Depreciation and amounts written off tangible fixed assets		
- owned by the company	173	143
- held under finance leases	-	12
Amortisation of intangible assets	682	593
Operating lease rentals		
- plant and machinery	4	5
- property rent	200	169
Auditors' remuneration		
- for audit services	20	23
- for non-audit services	8	3
Research and development	804	1,046
Exchange (gains) / losses	(63)	22
Government grants	<u>(20)</u>	<u>(260)</u>

5. Loss on ordinary activities before taxation (continued)

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Other operating expenses comprise:		
- other expenses	6,373	6,907
- depreciation	173	155
- amortisation of intangible assets	682	593
Other operating expenses	<u>7,228</u>	<u>7,655</u>
Loss on disposal of discontinued operation comprises:		
- loss on disposal of games publishing business	2,737	-
- disposal of goodwill	961	-
	<u>3,698</u>	<u>-</u>

6. Staff costs

The average monthly number of employees (including executive directors) was:

	Year ended 31 March 2006 Number	Fifteen months ended 31 March 2005 Number
Product design	83	84
Sales and marketing	20	10
Administration	19	16
	<u>122</u>	<u>110</u>
Their aggregate remuneration comprised:	£'000	£'000
Wages and salaries	3,723	4,174
Social security costs	454	412
Other pension costs (see note 32)	108	80
	<u>4,285</u>	<u>4,666</u>

Notes to financial statements

7. Directors' remuneration, interests and transactions

Aggregate remuneration

The total amounts for directors' remuneration and other benefits were as follows:

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Emoluments	450	480
Money purchase pension contributions	17	20
	<u>467</u>	<u>500</u>

The highest paid director received emoluments and benefits as follows:

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Emoluments	120	115
Money purchase pension contributions	4	5
	<u>124</u>	<u>120</u>

£12,000 (2005: £16,000) was paid to Brockhill Limited under agreements to provide the group with the services of Dr Christopher H B Honeyborne.

Four directors are members of money purchase pension schemes.

7. Directors' remuneration, interests and transactions (continued)**Directors' share options**

Aggregate emoluments disclosed above do not include any amounts for the value of options to acquire ordinary shares in the company granted to or held by the directors. Details of the options are as follows:

Name of director	1 April 2005	Granted	Exercised/ lapsed	31 March 2006	Exercise Price	Date from which exercisable	Expiry date
Dr Stuart A Green	1,250,000	-	-	1,250,000	10.5p	Apr 2007	Apr 2014
Dr Stuart A Green	-	1,000,000	-	1,000,000	10.5p	Jul 2008	Jul 2015
Ian C Stewart	1,250,000	-	-	1,250,000	10.5p	Apr 2007	Apr 2014
Robert G Deri	3,252,823	-	-	3,252,823	7.75p	*	
Robert G Deri	2,252,823	-	-	2,252,823	2.5p	Dec 2003	Aug 2013
Robert G Deri	1,000,000	-	-	1,000,000	Nil	Dec 2003	Aug 2013
Robert G Deri	1,250,000	-	-	1,250,000	10.5p	Apr 2007	Apr 2014
Andrew Scrivener	1,250,000	-	-	1,250,000	10.5p	Apr 2007	Apr 2014
M John Barnes	200,000	-	-	200,000	7.75p	*	
M John Barnes	250,000	-	-	250,000	11.0p	Apr 2007	Jul 2014
Dr Christopher H B Honeyborne	20,000	-	-	20,000	85p	Sep 2001	Mar 2010
Dr Christopher H B Honeyborne	200,000	-	-	200,000	7.75p	*	
Dr Christopher H B Honeyborne	250,000	-	-	250,000	11.0p	Apr 2007	Jul 2014
Total	12,425,646	1,000,000	-	13,425,646			

* These share options are exercisable on 19 July 2002 over 40% of the shares under option, on 19 July 2003 over a further 30% of the shares under option and in full on, or after, 19 July 2004, lapsing no later than 20 July 2011.

The share options held by John Barnes lapse post year end following his resignation from the board.

The market price of the ordinary shares at 31 March 2006 was 2.88p and the range during the period was 2.88p to 12.5p.

Notes to financial statements

7. Directors' remuneration, interests and transactions (continued)

Directors' interests

The directors who held office at 31 March 2006 had the following interests, including family interests, in the 0.2p ordinary shares of ZOO Digital Group plc:

Name of director	31 March 2006	31 March 2005
	Beneficial	Beneficial
Ian C Stewart	61,037,155	59,323,155
Robert G Deri	132,000	132,000
Andrew Scrivener	9,267,208	9,267,208
Dr Stuart A Green	9,641,500	9,641,500
M John Barnes	660,000	660,000
Dr Christopher H B Honeyborne	<u>100,000</u>	<u>100,000</u>

Dr Stuart A Green has options to acquire 5,250,000 ordinary shares from fellow shareholders, at 50p per share.

No changes took place in the interests of directors between 31 March 2006 and 31 August 2006.

Directors' transactions

No other transactions have taken place with directors aside from those disclosed in this note 7 or note 33.

8. Tax on loss on ordinary activities

a) Analysis of credit in the period

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
UK corporation tax		
Current tax on income for the period	-	(53)
Adjustments in respect of prior periods	-	-
	<u>-</u>	<u>(53)</u>

b) Factors affecting tax credit for year

The tax assessed for the year can be reconciled to the standard rate of corporation tax in the UK as follows:

	Year ended 31 March 2006 £'000	Fifteen months ended 31 March 2005 £'000
Loss on ordinary activities before tax	(8,249)	(2,280)
Loss on ordinary activities multiplied by standard rate of corporation tax of 30%	(2,475)	(684)
Depreciation in excess of capital allowances	105	(34)
Disallowable items	374	167
Losses carried forward	1,996	533
Adjustments in respect of prior periods	-	-
Research and development tax relief	-	(35)
Current tax credit for the year	<u>-</u>	<u>(53)</u>

The effect of the loss on disposal of discontinued operations has been to increase the tax losses carried forward by approximately £2,900,000.

c) Factors that may affect future tax charges

The group has tax losses carried forward of £14,430,000 (2005: £7,450,000).

Notes to financial statements

9. Loss attributable to ZOO Digital Group plc

The loss for the year dealt with in the financial statements of the parent company, ZOO Digital Group plc, was £5,889,000 (2005: £420,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

10. Dividends

There were no dividends paid or proposed.

11. Loss per share

The calculations of loss per share are based on the following losses and numbers of shares.

	Basic and Diluted	
	2006 £'000	2005 £'000
Loss for the financial year		
Continuing operations	3,101	1,627
Discontinued operations	5,148	600
	<u>8,249</u>	<u>2,227</u>
	2006 Number of shares	2005 Number of shares
Weighted average number of shares for basic and diluted loss per share	<u>308,920,444</u>	<u>279,333,785</u>

No adjustment has been made for 'in the money' share options as this would decrease the loss per share, which is not dilutive. No adjustment has been made for 'out of the money' share options based on the assumption that shareholders would not exercise these options.

The loss per share on discontinued activities is as follows:

	Year Ended 31 March 2006	Fifteen months ended 31 March 2005
Basic	(1.67p)	(0.22p)
Diluted	<u>(1.67p)</u>	<u>(0.22p)</u>

Notes to financial statements

12. Intangible fixed assets

Group	Goodwill	Development costs	Patents	Total
Cost	£'000	£'000	£'000	£'000
At 1 April 2005	10,423	327	133	10,883
Additions	-	201	98	299
At 31 March 2006	10,423	528	231	11,182
Amortisation				
At 1 April 2005	7,517	-	15	7,532
Charge for the year	350	316	16	682
Charge on disposal of discontinued operation	961	-	-	961
At 31 March 2006	8,828	316	31	9,175
Net book value				
At 31 March 2006	1,595	212	200	2,007
At 31 March 2005	2,906	327	118	3,351

Company	Goodwill
Cost	£'000
At 1 April 2005 and 31 March 2006	7,667
Amortisation	
At 1 April 2005	5,720
Charge for the year	352
At 31 March 2006	6,072
Net book value	
At 31 March 2006	1,595
At 31 March 2005	1,947

Notes to financial statements

13. Tangible fixed assets

Group	Leasehold improvements £'000	Computers £'000	Office equipment, fixtures & fittings £'000	Total £'000
Cost				
At 1 April 2005	12	718	355	1,085
Additions	-	155	16	171
Disposals	-	(78)	-	(78)
At 31 March 2006	12	795	371	1,178
Depreciation				
At 1 April 2005	9	529	170	708
Charge for the period	2	113	58	173
Eliminated on disposal	-	(45)	-	(45)
At 31 March 2006	11	597	228	836
Net book value				
At 31 March 2006	1	198	143	342
At 31 March 2005	3	189	185	377
Company	£'000	£'000	£'000	£'000
Cost				
At 1 April 2005	12	278	308	598
Additions	-	18	9	27
At 31 March 2006	12	296	317	625
Depreciation				
At 1 April 2005	9	247	162	418
Charge for the year	2	19	41	62
Disposal	-	-	-	-
At 31 March 2006	11	266	203	480
Net book value				
At 31 March 2006	1	30	114	145
At 31 March 2005	3	31	146	180

Notes to financial statements

14. Fixed asset investments

The parent company has investments in the following subsidiary undertakings:

	<i>Country of incorporation</i>	<i>Principal activity</i>	<i>Holding</i>	<i>%</i>
<i>Subsidiary undertakings</i>				
ZOOtech Limited	UK	Technology development	2 ordinary shares	100
ZOO Interactive Video Limited (formerly ZOO Digital Publishing Limited)	UK	Development of interactive DVD products	100 ordinary shares	100
The ZOO Media Corporation Limited	UK	Dormant	95,714 ordinary shares	100
ZOOtech Inc.	USA	Sale and distribution technology products	10,000 shares of common stock	100
ZOO Employee Share Trust Limited	UK	Employee Share Scheme	2 ordinary shares	100
ZOOtech SARL	France	Sale and distribution technology products	€5,000 of share capital	100

Subsidiary undertakings

	Company £'000
Cost	
At 1 April 2005 and 31 March 2006	9,414
Less disposals	(1,162)
At 31 March 2006	8,252
Amount written off	
At 1 April 2005 and 31 March 2006	1,467
Net book value	
At 31 March 2006	6,785
At 31 March 2005	7,947

Notes to financial statements

15. Stock

	Group		Company	
	31 March 2006 £'000	31 March 2005 £'000	31 March 2006 £'000	31 March 2005 £'000
Products in the course of development	48	191	-	-
Finished goods and goods for re-sale	-	712	-	-
	<u>48</u>	<u>903</u>	<u>-</u>	<u>-</u>

16. Debtors

Amounts falling due within one year:

	Group		Company	
	31 March 2006 £'000	31 March 2005 £'000	31 March 2006 £'000	31 March 2005 £'000
Trade debtors	1,242	3,756	-	37
Amounts owed by subsidiary undertakings	-	-	4,566	5,548
VAT	40	29	20	19
Other debtors	745	1,096	-	-
Prepayments and accrued income	472	1,056	201	118
	<u>2,499</u>	<u>5,937</u>	<u>4,787</u>	<u>5,722</u>

17. Creditors: Amounts falling due within one year

	Group		Company	
	31 March 2006 £'000	31 March 2005 £'000	31 March 2006 £'000	31 March 2005 £'000
Bank overdraft	317	729	-	-
Trade creditors	808	932	297	175
Other taxation and social security	215	264	102	245
Accruals and deferred income	1,616	1,696	232	58
Accrued pension contributions	6	9	6	9
	<u>2,962</u>	<u>3,630</u>	<u>637</u>	<u>487</u>

The bank overdraft is secured on the assets of the Group.

18. Creditors: Amounts falling due after more than one year

	Group		Company	
	31 March 2006 £'000	31 March 2005 £'000	31 March 2006 £'000	31 March 2005 £'000
Amounts owed to subsidiary undertakings	-	-	6,785	6,785

19. Derivatives and other financial instruments

The Group's financial instruments comprise cash and liquid resources, a bank overdraft, and various items, such as trade debtors, trade creditors etc. that arise directly from its' operations. The main purpose of these financial instruments is to raise finance for the Group's operations.

The directors do not consider that there is any material difference between the book value and the fair value of the Group's bank overdraft. At 31 March 2006 the Group had committed undrawn bank overdraft facilities of £683,000. The bank overdraft facilities are subject to monthly review.

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 foreign currency risk.

Interest is charged on the Group's bank overdraft on a variable basis at a rate of 1.75% above the bank base rate.

20. Provisions for liabilities and charges

No provision has been made for deferred tax assets as the period over which they are likely to be recovered is uncertain.

The amounts unprovided at the year-end are as follows:

	Group		Company	
	31 March 2006 £'000	31 March 2005 £'000	31 March 2006 £'000	31 March 2005 £'000
Deferred tax asset:				
- Accelerated capital allowances	50	66	52	64
- Short term timing differences	7	4	9	-
- Tax losses carried forward	4,362	2,235	1,743	1,789
	<u>4,419</u>	<u>2,305</u>	<u>1,804</u>	<u>1,853</u>

Notes to financial statements

21. Called-up share capital

	31 March 2006 £'000	31 March 2005 £'000
<i>Authorised</i>		
400,000,000 (2005: 400,000,000) ordinary shares of 0.2p each	<u>800</u>	<u>800</u>
<i>Allotted, called-up and fully-paid</i>		
317,327,828 (2005: 279,800,328) ordinary shares of 0.2p each	<u>635</u>	<u>559</u>

On 21 June 2005 37,200,000 ordinary shares of 0.2p were issued for consideration of £2,996,000

During the year 327,500 ordinary shares of 0.2p each were issued to employees under share option schemes for consideration of £9,000.

Options have been granted under the following option schemes to subscribe for ordinary shares of the company. As at 31 March 2006 the following options were outstanding:

Scheme name	Number of shares under option	Subscription price per share	Exercise period expires
Kazoo3D plc employee share option scheme*	150,600	50p	March 2010
Kazoo3D plc unapproved employee share option scheme*	331,900	10.5-85p	March 2010 – July 2015
Kazoo3D plc cross-over share option scheme*	1,041,000	50p	March 2010
ZOO Digital Group plc roll-over share option scheme	3,052,600	0.01199p	December 2010
ZOO Digital Group plc Enterprise Management Incentive Scheme*	14,593,950	Nil – 13.5p	July 2011 – July 2015
ZOO Digital Group plc Unapproved Employee Share Option Scheme*	<u>10,008,196</u>	Nil – 10.5p	July 2011 – July 2015
	<u>29,178,246</u>		

*Under these schemes the percentage of shares that can be exercised is staggered over the exercise period with typically 40% exercisable within the first two years and a further 30% in each of the next two years.

Notes to financial statements

22. Reserves

Group	Share premium account £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 April 2005	18,719	8,598	(20,609)	6,708
Issue of shares	2,929	-	-	2,929
Retained loss for the period	-	-	(8,249)	(8,249)
At 31 March 2006	21,648	8,598	(28,858)	1,388
Company				
At 1 April 2005	18,719	7,394	(17,796)	8,317
Issue of shares	2,929	-	-	2,929
Retained loss for the period	-	-	(5,889)	(5,889)
At 31 March 2006	21,648	7,394	(23,685)	5,357

Other reserves comprise the merger reserve arising on the acquisition of The ZOO Media Corporation Limited and market value of options granted in connection with that acquisition.

23. Reconciliation of movements in group shareholders' funds

	31 March 2006 £'000	31 March 2005 £'000
Loss for the financial year	(8,249)	(2,227)
New shares issued	3,005	29
Net deduction from shareholders' funds	(5,244)	(2,198)
Opening shareholders' funds	7,267	9,465
Closing shareholders' funds	2,023	7,267
Interest in own shares	(89)	(329)
	1,934	6,938

24. Interest in own shares

	Group and Company £'000
Cost	
At 31 March 2005	329
Provision for impairment	(240)
At 31 March 2006	89

Notes to financial statements

24. Interest in own shares (continued)

The company operates The ZOO Employee Share Trust Limited (the Trust) for the benefit of the employees of the group. The directors of the Trust purchase the company's shares in the open market. During the year the company had an interest in 4,430,665 (2005: 4,430,665) of its ordinary 0.2p shares with a nominal value of £8,861 (2005: £8,861) and a market value of £89,000 (2005: £521,000). These represent 1.4% (2005: 1.6%) of the issued ordinary shares. The company has given financial assistance to the Trust, as permitted by Section 153(4)(b) of the Companies Act 1985, of £172,000 (2005: £172,000).

The shares are not allocated to specific employees and will be distributed in the future at the discretion of the directors.

Due to the company's current share price the directors have deemed the investment to have become impaired and a provision has been made accordingly.

25. Reconciliation of operating loss to operating cash flows

	31 March 2006 £'000	31 March 2005 £'000
Operating loss	(4,227)	(2,337)
Depreciation charges	173	155
Decrease / (Increase) in stock	281	(509)
Decrease / (Increase) in debtors	1,359	(2,777)
(Decrease) / Increase in creditors	(272)	573
Amortisation of intangible fixed assets	682	593
Net cash outflow from operating activities	(2,004)	(4,302)

26. Returns on investment and servicing of finance

	31 March 2006 £'000	31 March 2005 £'000
Interest received	25	99
Interest paid	(109)	(41)
Finance lease interest paid	-	(1)
Net cash (outflow)/inflow	(84)	57

27. Capital expenditure and financial investment

	31 March 2006 £'000	31 March 2005 £'000
Purchase of intangible fixed assets	(299)	(601)
Purchase of tangible fixed assets	(171)	(414)
Receipts from sales of fixed assets	-	9
Purchase of own shares	-	(101)
Net cash outflow	(470)	(1,107)

28. Financing

	31 March 2006 £'000	31 March 2005 £'000
Repayment of director's loan	-	(857)
Issue of share capital	3,005	29
Net cash inflow/(outflow)	3,005	(828)

29. Analysis of changes in net debt

	At 1 April 2005 £'000	Cash flows £'000	Non cash movements £'000	At 31 March 2006 £'000
Bank overdraft	(729)	412	-	(317)

30. Exceptional items

On 31 March 2006 the group disposed of the trade and assets of its games publishing business. No cashflow has resulted from this transaction as the consideration of £250,000 has been deferred.

The exceptional item of £35,000 relates to costs incurred in relation to the disposal of the games publishing business.

Notes to financial statements

31. Financial commitments

Commitments under non-cancellable operating leases are as follows:

	Land and Buildings		Other	
	31 March	31 March	31 March	31 March
	2006	2005	2006	2005
	£'000	£'000	£'000	£'000
Group				
Expiry date				
- within one year	-	-	-	-
- between two and five years	200	200	-	4
	<u>200</u>	<u>200</u>	<u>-</u>	<u>4</u>

	Land and Buildings	
	31 March	31 March
	2006	2005
	£'000	£'000
Company		
Expiry date		
- within one year	-	-
- between two and five years	160	160
	<u>160</u>	<u>160</u>

Included in commitments expiring between two and five years is an amount of £200,000 (2005: £200,000) due within the next year in respect of a lease for land and buildings. Leases of land and buildings are typically subject to rent reviews at specified intervals and provide for the lessee to pay all insurance, maintenance and repair costs.

32. Pension arrangements

The company makes payment of contributions into certain employees' personal pension schemes for which the pension cost charge for the period amounted to £108,000 (2005: £80,000).

33. Related party transactions

During the year the group purchased goods and services in the ordinary course of business from LightWork Design Limited, of which Dr Stuart A Green was a director during the year, at a cost of £70,000 (2005: £87,500). Sales of licences were also made to LightWork Design Limited in the normal course of business amounting to £70,000 (2005: £87,500). At 31 March 2006 the balance owed to LightWork Design Limited was £nil (2005: £nil).

34. Post balance sheet events

On 27 September 2006 the company raised £3.98 million (net of expenses) through the issue of convertible loan stock and a placing of 110,000,000 new ordinary shares of 0.2 pence for a consideration of 0.65 pence per ordinary share.