ZYTRONIC PLC

Registration number 3881244

Annual report and financial statements 2006

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Business overview

Zytronic is an industry leader in the development and manufacture of customised optical filters to enhance electronic display performance. It is also an innovator in the production of specialised and transparent laminates for niche markets.

Based on this lamination expertise, Zytronic has developed a unique range of touch sensor products employing projected capacitive technology ("PCT™") which enables the pointing device (a finger) to sense through an anti-vandal screen in front of the display. This system offers significant benefits to electronic display manufacturers.

Operating from modern factories near Newcastle-upon-Tyne in England, Zytronic assembles touch sensors and filters, utilising special glass and plastic materials, in environmentally controlled clean rooms.

Our markets

As shown on the map of the world on the right, the Group has expanded its customer base and distribution and representation networks over recent years so that it now sells into most of the world's leading economies.

Since 2005, we have expanded our overseas representation to include a country-wide force of representatives in the USA, and this year added to our coverage in the Far East in India, Japan, Korea and Singapore, and also extended into nine countries of Eastern Europe. We now have 14 representatives covering all of the US and Canada, 7 distributors in the Far East and 17 distributors in Eastern and Western Europe.

The range of applications for our touch sensors is as wide as the imagination of leading designers. It includes use in ATM's, petrol pumps, ticketing machines, information displays, gaming machines, food retailing, jukeboxes, medical equipment, keypads, solar-powered parking meters, diagnostic engineering equipment and helicopter simulation machines. There are many other and more varied uses.

+32.5%

growth in order intake

● Countries in which Zytronic made sales in FY 2005 and 2006

Electronic touch sensors and optical and other filters

Touch sensors

The manufacturing technology, PCT™, employed for its touch sensors is unique to Zytronic and offers significant benefits to traditional users of resistive, capacitive and Surface Acoustic Wave ("SAW") technologies. Unlike the other touch technologies, the active component of Zytronic's technology is embedded for protection, providing a true safety laminated, pure glass fronted construction.

PCT™ offers significant benefits to electronic display manufacturers. The touch-sensing layer consists of an array of microfine wires that are not visible on a powered display. Zytronic has now introduced a family of touch sensors using its patented PCT™, marketed as ZYTOUCH®, ZYPOS®, ZYBRID® and ZYSWITCH® touch sensors to meet customers' differing requirements.

Optical filters and displays

Zytronic optical filters are used to enhance the readability of all types of electronic displays by controlling light transmission, reflection and absorption. The filters can also provide protection of the display from abrasion and impact damage thereby extending the life of the display.

Both monolithic and multi-layer composites in glass or polycarbonate or acrylic are available. The optical laminations are manufactured by bonding together, under carefully controlled conditions, two or more glass or plastic materials using proprietary bonding techniques.

Zytronic produces a wide range of optical filters which are designed to meet specific customer requirements for viewability of display systems in different environments.

Case studies – touch sensors

Pro-Tech

Pro-Tech has pioneered outdoor sales terminals, allowing users to order food and other travel essentials as easily as if they were at the shop counter. Fuel and food outlets everywhere are boosting sales by deploying Pro-Tech kiosks. Zytronic's ZYTOUCH® projected capacitive touch sensors maximise availability and durability and minimise ownership costs

"Only ZYTOUCH® met all our criteria concerning environmental conditions, legibility at any ambient level, and very high resistance to accidental or wilful damage. ZYTOUCH® is a critical enabler of this emerging market sector."
Peter Kaszycki, president of Pro-Tech.

Tokheim

Forecourt fuel pump giant Tokheim chose a PCT™-based 6.4 inch ZYTOUCH® touch sensor with toughened glass for its OPTimum iQ™ range of customer direct Pay @ Pump terminals, which also includes a PCT™ secure keypad solution.

ZYTOUCH® was chosen because it offers superior optical clarity, which ensures that the screen may still be read even in sunlight. Accurate sensing, even with gloves, delivers high performance, plus unparalleled resistance to extreme temperature variations, accidental or malicious damage, and surface degradation caused by the operational environment.

RFI/EMI shielded filters

Electromagnetic Interference ("EMI") can be described as any form of electrical disturbance, signal or noise which interferes with the ability of electrical or electronic equipment to function correctly.

This interference is also referred to as Radio Frequency Interference ("RFI") and is active throughout the environment. Its effects vary from impaired TV or radio reception to severe disruption of communications, data processing and medical and defence activities. Its sources are both natural and man-made. It is also necessary to contain emitted signals from computer and data handling equipment to prevent electronic eavesdropping for example.

Zytronic has its own specialist plating plant to enable it to manufacture such filters to customers' exacting specifications.

Other laminated products

Laminated products

Laminated glass is produced by bonding two or more layers of glass together by means of a special plasticised interlayer, polyvinyl butyral ("PVB").

This interlayer, after processing under controlled heat and pressure conditions, assumes a similar refractive index to the glass – consequently having no adverse effects upon light transmission – and at the same time, absorbing over 99% of the harmful ultraviolet rays found in natural sunlight. The excellent bond strength of the PVB to glass serves to maintain the integrity of the laminate in the event of deliberate or accidental damage, whilst also preventing penetration through the assembly.

Amongst such products, Zytronic manufactures light diffusers for London Underground and other transport companies.

Ballistic visors

Zytronic is a manufacturer of specialist glass and plastic composites for ballistic security and specialised display applications.

Zytronic has developed a fully laminated ballistic face visor combining the properties of PMMA and polycarbonate bonded together using a proprietary TPU sheet interlayer.

The unique process involved in bonding these two materials results in the finished visor offering supreme optical quality, minimal distortion and the highest light transmission when compared to the traditional air-spaced option.

Channel 1 Games

Channel 1 Games sought extremely high resistance to everyday wear and tear for its new gaming experience called IND:E, Interactive Networkable Digital Entertainment, as well as maximum design and styling freedom to ensure rapid player response, and optimum game play interactivity.

ZYTOUCH® PCT™ Through-Glass enables the optimum solution: a 19-inch custom-designed 5mm-thick touch sensor, which is positioned behind, and senses through, 6mm of thermally tempered sacrificial glass to protect against contaminants such as sticky drinks, cleaning agents, plus accidental and malicious damage.

Westland Helicopters

Versatility makes ZYTOUCH® perfect for specialist applications - such as the 1.5m x 0.6m touch sensor that simulates an entire helicopter control panel at Westland Helicopters' technology and simulation centre.

In combination with a rear projection film, ZYTOUCH® easily combined with Westland's virtual instrument panel software, creating a panel that can be quickly reconfigured during customer trials to meet requirements, within hours rather than weeks.

"No other currently available technology can give us this flexibility. Pilots can now interact with virtual instruments as soon as they have been redrawn."
Paul Brinson, assistant chief engineer, Westland Helicopters Ltd.

Aeroflex

The Aeroflex 6413A Base Station Test System features PCT™ to deliver enhanced ease of use and durability, while eliminating hardware and low level drivers required by conventional switches or keypads.

Portability and reliability are increased and thanks to the ZYTOUCH® sensor, the controls can be dynamically reassigned to optimally support multiple operational modes, and reconfigured to accommodate evolving 3G standards. Different product variants can easily be created.

"The use of the touchscreen made for a fast and easy development, and has also enhanced the product."
Bob Miller, senior project manager, Aeroflex.

Highlights

Financial highlights

Group turnover of £12.3m showed growth of 16%
(2005: £10.6m)

Gross profit margin increased for fourth consecutive year,
to 31.3% (2005: 31.0%)

Profit before tax increased by a third to £1.31m
(2005: £0.98m)

Tax charge reduced from 31.5% to 12.0%

Basic EPS increased by 70% from 4.7p to 8.0p

Final dividend proposed of 2.0p – total for year 3.0p
(2005: 2.0p)

Operational highlights

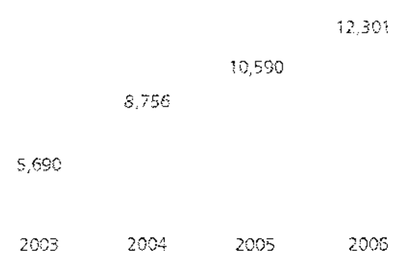
Increasing sales of ZYPOS® and ZYBRID® touch sensors

Appointed new distributors in six countries

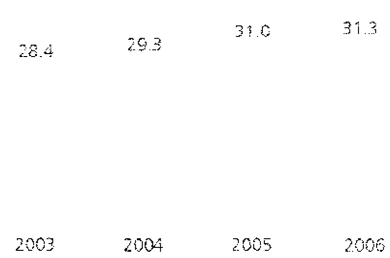
Developed further product variations, ZYSWITCH® –
a touch-switch product

Significant investment in freehold property for expansion

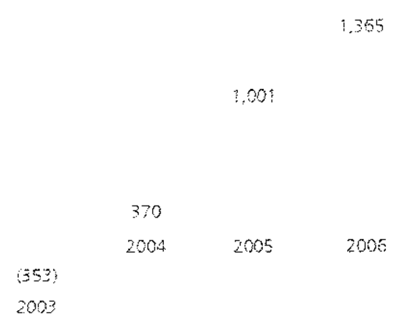
Turnover (£'000)



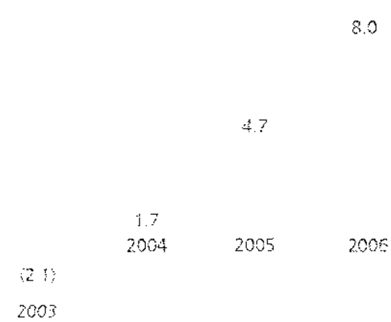
Gross profit margin (%)



Operating profit ("PBIT") (£'000)



Earnings per share ("EPS") (Pence)



Chairman's statement

Summary of Chairman's Statement

Turnover up 16% to £12.3m (2005: £10.6m)

Operating profit up 36% to £1.365m (2005: £1.001m)

Strong growth of 32.5% in new orders received

Development of new ZYPOS® production facility commenced

Final dividend proposed of 2.0p (full year 3.0p)

Continued confidence going forward

"The strength of the touch sensor market, the increase in the level of new business written in 2006 and, more importantly, the very successful introduction of Zypos® touch sensors into the marketplace, give the Directors continued confidence in the Group's operations going forward."

With the continuing strong growth in sales, the financial results to 30 September 2006 demonstrate the ongoing improvement in the performance of the business.

Results

Turnover for the year under review increased by 16% to £12.3m (2005: £10.6m) resulting in a 33% increase in pre-tax profits to £1.31m (2005: £0.98m). Growth in basic earnings per share of 70% to 8.0p (2005: 4.7p) has been helped by a reduced tax charge.

Trading

Growth in sales of 16% includes £310,000 of sales of our new ZYPOS® touch sensor product. The balance of sales growth in the year has been evenly spread between the Group's traditional products and ZYTOUCH® touch sensors.

The expansion of the sales network in Europe and the Far East and, more importantly, the effectiveness of the network established in the United States last year, has led to a strong growth in new orders received of 33%, giving the Group a stronger order book as we move into the new financial year.

The new ZYPOS® product has played an important part in this growth and has now been specified into a number of high profile projects in the United States and the Far East, particularly in the fields of fast food retailing, ticketing and petrol pumps, and through to parking meters and taxi cabs.

A seven inch ZYPOS® touch sensor used in a Sat Nav car navigation system.

An mjoy jukebox manufactured in Germany incorporating a ZYTOUCH® touch sensor.

Music Post, a state of the art audio/video jukebox, from Sound Leisure.

This growth in new orders received, together with the diversity of application for which these products may be used, provides an exciting future for the Group.

Investment

In the year ended 30 September 2006, the total investment in fixed assets was £1.926m and working capital increased by £526,000 as a result of the growth in sales. These have been funded from the Group's cash resources and by way of a £750,000 medium term loan. Cash balances at the year-end were £0.5m and net debt was £0.4m.

With the strong and growing demand for ZYPOS® touch sensors, the Directors have commenced the capital investment programme to convert the properties acquired in December 2005 into a new ZYPOS® production facility. Approximately £1.5m will be invested in new clean rooms and other plant and equipment. The existing production facilities will be adequate to meet demand until the new factory comes on stream in the Summer of 2007. It is anticipated that these new facilities will improve production capacity in ZYPOS® touch sensors which is expected to increase profitability in the 2008 financial year.

Dividend

The Directors recommend a final dividend of 2.0p per share payable on 16 March 2007 to shareholders on the Register of Members on 2 March 2007 which, following a dividend of 1.0p per share paid in June 2006, will bring the total dividend for the year to 3.0p per share (2005: 2.0p per share).

Outlook

The strength of the touch sensor market, the increase in the level of new business written in 2006 and, more importantly, the very successful introduction of ZYPOS® touch sensors into the marketplace, give the Directors continued confidence in the Group's operations going forward.

J M Kennair MBE
Chairman
4 January 2007

Financial review

Summary of Financial Review

Gross profit of £3.9m (2005: £3.3m)

Gross profit margin of 31.3% (2005: 31.0%)

Profit before tax £1.31m (2005: £0.98m)

Tax charge reduced to 12.0%

Basic EPS increased by 70% to 8.0p (2005: 4.7p)

"A summary of the results over the last three years shows the strong growth in sales, the continuing increase in the gross profit percentage and the improving profitability of the business."

Trading results

A summary of the results over the last three years shows the strong growth in sales, the continuing increase in the gross profit percentage and the improving profitability of the business:

	2006 £'000	2005 £'000	2004 £'000
Turnover	**12,301**	10,590	8,756
Gross profit	**3,852**	3,278	2,569
Gross profit %	**31.3%**	31.0%	29.3%
Profit before tax	**1,312**	984	350

Turnover

Overall growth

For the full year, the Group has achieved growth in sales of 16%. However sales growth in the second half was much stronger at 21.0% (£6.63m against £5.48m) than in the first half at 10.9% (£5.67m against £5.11m).

Sales growth in the first half was adversely affected by the introduction of the new European Community Directive (2002/95/EC) entitled "The Restriction of the use of certain Hazardous Substances in electrical and electronic equipment" which came into effect from 1 July 2006.

An Aeroflex 6413A Base Station Test System incorporating a ZYTOUCH® touch sensor – see case study on inside front cover.

A Tokheim petrol pump showing the use of a ZYTOUCH® touch sensor and separate ZYTOUCH® keypad – see case study on inside front cover.

The RoHS regulations, which ban the sale in Europe of components containing certain metals, led to customers running down their stocks ahead of the development of RoHS-compliant products. This de-stocking reduced our sales in H1. H2 has had some additional benefit as customers have begun to build up their stocks again since July.

During the year we have seen particular strength in sales of touchscreens and optical displays in the ATM, information kiosk, petrol pump and ticketing sectors and good performances in others, including entertainment. Our top ten customers have continued to grow and there is a strong performance from the middle range of customers, some of whom have grown significantly during the year. We continue to win new customers and have some very good new sales prospects for financial years 2007 and 2008.

Gross profit

The gross profit at £3.9m increased by £0.6m (18%) on the prior year. The gross margin percentage continued to increase this year, by 0.3% to 31.3%, building on the progress seen since 2002.

As can be seen from note 3, the average number of production employees during the year was only one higher than in the prior year at 147. Sales per employee therefore increased, contributing to the improvement in the gross margin.

To ensure that we continue to improve the gross margin percentage, we review regularly the sources and costs of raw material supplies, the design of our products and the processes that we are using in their manufacture as well as our number and use of staff.

Administrative overheads

We have continued to keep these costs under tight control during the year. The net increase was £180,000 (£2.32m against £2.14m) some 8%. The increase largely reflects the recruitment of staff into the technical, sales and administration departments (see note 3) and increasing spend on marketing and travel to service our growing global customer base.

Research and development

Accounting

The Group has continued to invest significant amounts in developing its electronics and materials technologies during the year. The Directors have capitalised development expenditure of £154,000 (2005: £192,000) and expenditure on licences of £5,000 (2005: £9,000). £135,000 was expensed to trading profit (2005: £169,000).

Taxation

The Directors have continued to take advantage of the Government's incentives for research and development ("R&D"), through the Inland Revenue's R&D tax credit scheme. Under this scheme, the Group can claim an additional tax credit of 50% on qualifying R&D expenditure. The benefit of this to the tax charge is shown in note 5.

Financial review (continued)

A 40 inch rear projection touchscreen.

Two examples of the use of ZYSWITCH® touch-switch sensors; the left-hand one shows switch controls on either side of a central video screen, while the right-hand one shows a bank of switches for a lift.

Pre-tax profit

The pre-tax profit of £1,312,000 reflects a significant improvement of 33% over the prior year's profit of £984,000. The reasons for this excellent performance are noted elsewhere in this review and the Chairman's statement.

Taxation

The Group's taxation charge reduced this year to £158,000 (12.0%) from £310,000 (31.5%) despite the increase in pre-tax profit. This substantial decrease arose this year particularly due to the exercise of share options during the year for which significant corporation tax allowances were given. These allowances will arise in future years but their timing and amount is uncertain. It is likely that they will not be as significant as in the current year due to the lower quantities, and spread of exercise dates, of outstanding options. The other factors which affect the Group's taxation charge are outlined further in note 5 to the financial statements and in the Research and development part of page 5.

Earnings per share ("EPS") and dividends

Basic EPS of 8.0p (2005: 4.7p) reflects the significant improvement in profitability. The number of shares in issue increased during the year by 340,390 to 14,640,359 following the exercise of several options as outlined in note 19.

The Group paid an interim dividend of 1.0p on 30 June 2006. With the improving profitability seen in the second half of financial year 2006, the Group intends to continue its progressive dividend policy. A resolution to approve the payment of a final dividend for the year ended 30 September 2006 of 2.0p is included in the Notice of Annual General Meeting. This will bring the total dividend for the year to 3.0p (2005: 2.0p).

Cashflow and working capital

The Group has continued to generate gross cash at the operating level (note 21) and this has increased again with the growth in profitability. As expected, our working capital has increased with the growth in the Group's business. After three years of keeping stocks in the range of £1.1m to £1.2m they increased this year to £1.7m. The increase has been in raw material stocks to ensure that we have sufficient quantities on hand to meet the growth in sales and the ever-shortening delivery times being expected by our customers. Debtors have increased again this year with the growth in turnover and the lengthening of the credit period given the increasing level of exports.

Tommy Rice watches over micro-fine stainless steel mesh, for RFI and EMI products, which is being plated with silver, and then blackened, by our automatic, computer-controlled linear plating plant.

Alan Thompson oversees glass panels for ZYTOUCH® touch sensors, which are automatically passing from a washing machine into the glass tempering (toughening) plant. This new plant was commissioned in April 2006.

Capital expenditure on fixed assets

The Group has continued to add plant and equipment selectively where it contributes to an improvement in manufacturing efficiency or a reduction in costs, or where it is necessary to enable the manufacture of a new product.

The largest call on the Group's operating cashflow has been in adding to the Group's fixed assets base. These additions totalled some £1.9m. £868,000 was spent on acquiring the freehold of the adjoining factory and in some initial refurbishment work. The main refurbishment work and the equipping of it for ZYPOS® touch sensor manufacture will take place in this current financial year as outlined in the Chairman's statement. We also added an extension to one of our two leasehold factories to accommodate the new toughening plant which was commissioned in April 2006. These acquisitions were referred to, at some length, in my Financial Review last year. The extension cost some £100,000 and additions to plant and machinery were over £765,000.

Capital additions to intangible fixed assets were some £159,000 reflecting the work undertaken on developing the technology of the Group.

We undertook a review of the fixed assets register this year to identify assets that were not in continued use within the business. Plant and machinery with a cost of £1,414,000 and accumulated depreciation of £1,412,000 has been written out of the accounts as a consequence.

Funding and gearing

As set out in note 15(b), the Group took out a ten year mortgage for £750,000 to cover the initial cost of the freehold factory acquisition. The Group did not take out any other borrowings during the year. It continued with repayments on its finance lease and its three year bank loan (both of which finish during financial year 2007) together totalling £233,000. At 30 September 2006 borrowings were £873,000 and net debt was £380,000.

D G W Mullan, B.Sc, FCA
Finance Director
4 January 2007

Directors, senior management and advisers

Board of Directors

John Martin Kennair MBE
(D.O.B. 11/03/44) (2)
Chairman and Chief Executive
John joined the Romag Group in 1971 and was appointed Group Chief Executive in 1975. He was responsible for the development of the glass business of the Romag Group into a wide range of new technologies, including bomb and bullet resistant glass, electronic shielding and touch sensors. In 1990 he was awarded an MBE for services to the specialised glass industry. He led the demerger of Zytronic Displays Limited from the Romag Group and the flotation of its parent company, Zytronic plc, in July 2000. He also led the subsequent flotation on AIM in November 2003 of Romag Holdings plc, of which he is Chairman.

Denis Gerald Wilson Mullan B.Sc, FCA
(D.O.B. 08/02/54)
Finance Director
Denis was formerly a partner in Ernst & Young LLP, specialising in corporate finance. He was based successively in its offices in London, Newcastle-upon-Tyne and finally Bristol. While based in Ernst & Young's Newcastle-upon-Tyne office, he led its work on the demerger of Zytronic Displays Limited in June 2000 and the subsequent admission to AIM of Zytronic plc in July 2000. Shortly thereafter he transferred to Ernst & Young's Bristol office at which time his formal advisory role to the Company ceased. He joined the Group in August 2003.

Tudor Griffith Davies B.Sc
(D.O.B. 02/12/51) (1) (2)
Senior Independent Non-executive Director
Tudor has wide industry experience at boardroom level, as Chairman, Chief Executive and Executive and Non-executive Director of several public companies, including previously of Hicking Pentecost plc, Stratagem plc and Dowding & Mills plc. He was formerly a partner in Arthur Young (a predecessor firm of Ernst & Young LLP) specialising in corporate finance and recovery.

Key senior management of Zytronic Displays Limited

Mark Cambridge
Managing Director
Mark graduated with a B.Sc. (Hons) in Materials Science in 1986 and has a Securities Institute Certificate in Corporate Finance (2003). Joining the Romag Group of companies in 1991, he held the positions of Technical Manager, Quality Manager and Technical and Quality Director, up to the demerger and flotation of Zytronic. Since 2000 he has overseen the development, market introduction and sales of the ZYTOUCH® touch sensor product and the market launch of ZYPOS® touch sensors. Mark was Sales and Marketing Director of Zytronic Displays Limited from 2002 until his appointment as its Managing Director in February 2006.

Subsequent to Mark's move from Sales and Marketing Director to Managing Director, Zytronic Displays Limited has recruited a replacement who will join in early 2007.

Dave Carr
Production Director
Prior to joining Romag Glass Products Limited, since renamed Zytronic Displays Limited, in 1986 as Production Manager, Dave spent 18 years at NEI Reyrolle, initially in an engineering role and latterly in a supervisory capacity, and two years as Production Manager with the Ronson Group. He was appointed to the position of Production Director in 1993, since when he has overseen all aspects of manufacturing, including the trialling and successful introduction of the ZYTOUCH® and ZYPOS® touch sensors.

Sir David Robert Macgowan Chapman Bt., DL, B Comm

(D.O.B. 16/12/41) (1) (2)

Independent Non-executive Director

Sir David is a former Director of Northern Rock plc and the London Stock Exchange and a member of the Greenbury Committee on Corporate Governance. He is a Director of a number of regional venture capital funds. A former Chairman of CBI – North East and a First Vice President of Merrill Lynch International Bank, Sir David is currently a consultant with UBS Wealth Management (UK) Limited.

David Eric Banks MA (Cantab), FCA

(D.O.B. 13/08/53)

Non-executive Director and Deputy Chairman

David held a variety of positions in industry at Director level before forming David Banks Associates, which provides temporary and part time assistance in financial supervision and management. He was appointed Finance Director of Zytronic plc in June 2000, prior to its flotation, and became a Non-executive Director with effect from 1 September 2003 following the appointment of Denis Mullan to that role. He is also Finance Director of Romag Holdings plc.

All of these Directors served throughout the financial year.

(1) member of audit committee
(2) member of remuneration committee

Dr Andrew Morrison Ph.D., MIEE, MIEEE

Technical Director

Andrew graduated from the University of Newcastle-upon-Tyne with a First Class BEng (Hons) degree in Electrical and Electronic Engineering. Andrew was also awarded a PhD by the University for research collaborations with American based semiconductor company Applied Materials and Siemens UK on digital signal processing algorithm development and digital communications for 3G cellular technology. Andrew initially worked in the display industry with world leader LG Phillips Displays in Europe and the UK before he joined Zytronic Displays Limited in 2002. Andrew leads a growing team which is actively involved in all aspects of the electronic and software research and development of Zytronic's PCT™ touch sensor product range.

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Denis G W Mullan FCA
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Directors' report

The Directors present their report and financial statements for the year ended 30 September 2006.

Business review

Details of developments and the progress of the Group are contained within this Business review as well as in the Chairman's statement and the Financial review.

Principal activities

Zytronic is an industry leader in the development and manufacture of customised optical filters to enhance electronic display performance. It is also an innovator in the production of specialised and transparent laminates for niche markets. Based on this lamination expertise, Zytronic has developed a unique range of electronic touch sensor products employing PCT™ which enables the pointing device (a finger) to sense through the overlay in front of the display. This system offers significant benefits to electronic display manufacturers.

Competitive advantages

The Group's competitive advantages are based upon both the patented technology relating to the operation of the touch sensors and the lamination techniques and processes, built up over 40 years of operations, which are a feature of all the Group's products. These advantages allow the Group to produce products which have optical clarity and ruggedness, and can be customised to include individual features for customers, including privacy filters and anti-reflective and anti-glare properties. In the case of touch sensors, these advantages also result in the significant ability for them to be used by bare fingers and gloved hands and results in them not experiencing positional drift and therefore not requiring periodic re-calibration.

The growth of the Group and its future prospects come from the exploitation of this relatively new touch sensor technology. Differing adaptations of this patented technology have resulted in three different product groups being developed: ZYTOUCH® touch sensors and keypads; ZYPOS®, and its derivative ZYBRID®, touch sensors; and ZYSWITCH® touch-switch sensors. ZYTOUCH®, ZYPOS® and ZYBRID® touch sensors are designed to work in front of LCD's or other electronic devices and optical clarity is paramount. Conversely the technology has been adapted to produce ZYTOUCH® keypads and ZYSWITCH® touch-switch sensors which are not required to be transparent.

The Group's Intellectual Property Rights ("IPR") include confidential operations and processes, technology covered by patents and licensed technology. Over the last three years the Group has taken steps to protect its IPR by the renegotiation and registration of a new licence and by registering trademarks and copyrights.

The Group will continue to identify further opportunities for the development of new product groups and expends a considerable amount on R&D. By continually developing and adapting its technologies the Group has been able to expand the applications of the touch sensors into a widening range of applications and new sectors of business and to promote the Group's products on a global basis. At present over 60% of all products are directly exported from the UK, with a significant proportion of UK sales eventually being exported as well.

The Group has continued the expansion of its worldwide selling operations, expanding its direct sales force, based at the Group's head office at Blaydon-on-Tyne, and appointing further representatives and distributors in the United States, Eastern Europe, the Far East and India. Management is continuing to look for suitable appointees to expand the Group's presence worldwide.

Business risks

The main risk to the Group's business is that of advances in competing technology, whereby a new, better touch sensor technology is created. Management is conscious of this and keeps a watch on competitors' developments and on changes within the whole industry. By continually developing and evolving its own technologies, the Group expects to build upon its competitive strengths and thereby keep its technology ahead of its competitors.

Another competitive risk arises from downward price pressures from competing technologies. This is most prevalent in the lower valued touch sensor sector dominated by resistive, capacitive and surface acoustic wave touchscreens, as new Asian manufacturers take advantage of the demise of the technology patents on those product types. Price pressure in those markets has a knock-on effect on prices throughout the industry.

Management has successfully met those challenges to date by re-designing and re-engineering the ZYTOUCH® touch sensor in developing the ZYPOS® touch sensor. This has enabled the Group to reduce the cost of manufacture and therefore the sales price for ZYPOS® touch sensors and allowed the Group to get into markets that were previously closed to it on price grounds.

Management is also continually reviewing the sources and costs of raw material supplies, the design of the Group's products and the operational processes that are used in the manufacture of all of the Group's products.

A further risk, which is directly within the control of management, is that of managing increases in the overhead base to coincide with the growth in turnover, thereby maintaining the growth in profitability. This is not straight forward when the business is developing new products and manufacturing processes. A current example of this risk arises from managing the timing of the refurbishment and development of the recently acquired adjoining factory premises. This work and expenditure needs to be undertaken to tie in with the growth in ZYPOS® sales beyond the current intermediate ZYPOS® manufacturing capacity in the Group's existing factories. Management foresees the timescale to develop new production facilities as being in Summer 2007. It is important, therefore, to complete the work on the new facilities to fit in with that timescale. Any earlier and the Group would incur unnecessary additional overheads.

A fourth risk is that, as a growing proportion of the Group's sales are denominated in United States Dollars and Euros, the Group is subject to risks associated with currency movements. It is the Group's policy to manage these risks and provide a degree of certainty for cashflows into the UK. Note 18 sets out details of the Group's financial risk management policy and financial instruments, including its management of its foreign exchange risk.

Natural hedging is adopted to manage currency risk, whereby goods and services are sourced from Continental Europe and the USA and the liability arises in the respective currencies. This is especially relevant with specialised glass, some electronic components and certain other raw materials.

The use of forward foreign exchange contracts will continue to be considered having been used previously in 2003/2004. Some currency is un-hedged, being dealt with at the spot rate when required. The Group's exposure to foreign exchange losses may also be reduced in the future by undertaking some borrowing in overseas currencies, especially where plant and machinery is sourced from abroad.

The Group does not hold speculative positions against movements in foreign currencies or interest rates.

Business review (continued)

Key performance indicators ("KPIs")

The KPIs for the business, at this stage of its development, are primarily financial.

The current KPIs consist of setting targets for and monitoring the level and growth of sales; improving the gross profit margin; and controlling the level of overheads. The Directors set targets for the operating management in terms of sales growth and margin improvement. The actual performance of the Group against each of these KPIs is set out in the Chairman's statement and/or the Financial review.

In addition, the Directors review an "activity monitor" which the sales team uses to record significant sales opportunities, the key dates in the development of each sales prospect with the customer, volumes and values of the opportunities and expected production commencement dates.

The Directors have not developed KPIs relating to environmental matters; the Group's employees; or social and community issues.

However in the last year the Directors have ensured that the business has been able to comply with the new RoHS regulations which came into effect on 1 July 2006. This has required close working with both suppliers and customers in sourcing new raw materials and components and required changes to operational processes to avoid the use of lead and certain other restricted metals in our products. These restrictions prohibit the sale in Europe of all products, from that date, which do not meet the criteria. All the Group's products met the requirements by the due date.

The Directors also maintain a close watch on the level, and competitiveness, of wages paid to factory staff, and the market level of staff salaries, to ensure that the Group is not at a disadvantage when seeking to recruit staff or to retain them. The Group also uses share option schemes to incentivise employees. The Remuneration report summarises the policies relating to executive management.

Results and dividends

The Group profit and loss account is set out on page 22. The Group profit after taxation amounted to £1,154,000 (2005: £674,000). The Directors propose the payment of a final dividend of 2.0p per share (2005: 1.5p). Following the dividend of 1.0p per share paid in June 2006, this will bring the total dividend for the year to 3.0p per share.

Directors

The Directors of the Company are shown on pages 8 and 9. All of these Directors were Directors for the whole of the year. The emoluments and interests of the Directors in the shares of the Company are set out in the Remuneration report.

Statement of Directors' responsibilities for the financial statements

The Directors are responsible for preparing the Annual report and financial statements in accordance with applicable United Kingdom 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 of the Group and of the profit or loss of the Group for that year. 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; and
- prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the 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 Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

The Directors confirm that the financial statements comply with the above requirements.

So far as each Director is aware, there is no relevant audit information of which the Company's auditors are unaware. Each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Significant interests in shares

On 8 December 2006, the following had notified an interest in the ordinary shares of the Company required to be disclosed to the Company in accordance with sections 198 to 208 of the Companies Act 1985.

Shareholders	*No. of shares*	*Percentage holding*
SIS SEGA Intersettle AG/Omnibus	3,306,222	22.58%
John M Kennair MBE – Chairman	2,347,519	16.03%
Axa S.A. (Framlington Investment Management Limited)	2,147,950	14.67%

Directors' report (continued)

Creditor payment policy and practice

It is the Group's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Group and its suppliers, provided that all trading terms and conditions have been complied with. At 30 September 2006, the Company had an average of 56 days (2005: 41 days) purchases outstanding in trade creditors.

Political and charitable contributions

The Group did not make any political or charitable contributions during the year (2005: £Nil).

Special business

A resolution will be proposed at the forthcoming Annual General Meeting to renew the existing authority of the Directors, last conferred by a resolution passed at the Annual General Meeting held in 2006, to allot unissued ordinary shares of the Company. The authority (special resolution 1 in the Notice of Annual General Meeting) will extend until the Annual General Meeting held in 2008 and is in respect of one-third of the Company's issued share capital.

The Directors consider it advisable that they continue to have power to make allotments of ordinary shares of the Company for cash without reference to the statutory pre-emption rights, up to a maximum of 1,464,036 ordinary shares, being 10% of the issued ordinary share capital of the Company at 30 September 2006. The authority (special resolution 2 in the Notice of Annual General Meeting) will extend until the Annual General Meeting held in 2008 and also would enable the Directors to implement a rights issue.

In addition, the Directors consider it advisable that the Company has the authority to make market purchases of its own shares up to a maximum of 1,464,036 ordinary shares of the Company, being 10% of the issued ordinary share capital. The authority (special resolution 3 in the Notice of Annual General Meeting) will extend until the Annual General Meeting held in 2008. The power conferred by this authority would only be used after careful consideration by the Directors, having taken into account market conditions prevailing at the time, the investment needs of the Company, its opportunities for expansion and its overall financial position. The authority would only be exercised by the Directors if they considered it to be in the best interests of shareholders generally and if the purchase(s) could be expected to result in an increase in earnings per share.

Auditors

A resolution to re-appoint Ernst & Young LLP as the Company's auditors will be put to the forthcoming Annual General Meeting.

By order of the Board

D G W Mullan, B.Sc, FCA
Company Secretary
4 January 2007

Corporate governance

As an AIM listed Company, Zytronic is not obliged to comply with the revised Combined Code published in July 2003 ("the Combined Code") but instead uses its provisions as a guide, but only as considered appropriate to the circumstances of the Company. The Directors note that the Combined Code was updated in June 2006 and they intend to give consideration to implementation of the changes to it.

The Company is committed to high standards of corporate governance. The Directors consider that, except for the matters noted below, the Company has, throughout the year, been in full compliance with the provisions set out in section 1 of the Combined Code:

- A2.1 As discussed below, with effect from 28 June 2004, the roles of Chairman and Chief Executive were not separated.
- A4.1 For reasons explained below, the Company does not have a separate nominations committee.
- A6 The Board has not undertaken a formal evaluation of its own performance and that of its committees and individual members.
- A7.2 The Non-executive Directors have not been appointed for a specific term.
- B2.1 The remuneration committee was chaired by the Group Chairman, rather than a Non-executive Director.
- C3.4 The Company has not yet put in place a formal whistle-blowing procedure.

In view of the size and structure of the Group, the Board does not believe that these exceptions had any detrimental effect on the control environment and corporate governance.

The workings of the Board and its committees

The Board

Throughout the year, the Board comprised John Kennair, the Chairman and Chief Executive, Denis Mullan, the Finance Director, Tudor Davies and Sir David Chapman, the two independent Non-executive Directors and David Banks, a Non-executive Director and Deputy Chairman. David Banks is not considered to be independent because he was the Finance Director of the Group until August 2003.

John Kennair stepped in, on an interim basis, as Chief Executive on 28 June 2004, following the resignation from the Board of Ian Lawson on that date. The Board has continued to assess the requirements of a new Chief Executive and the timing for that replacement. John Kennair is also the Chairman of Romag Holdings plc, another AIM company. As this is his only other business commitment, the Board considers that he is able to devote sufficient time to his responsibilities within the Group.

The Non-executive Directors demonstrate a range of experience and sufficient calibre to bring independent judgement on issues of strategy, performance, resources and standards of conduct which are vital to the success of the Group.

The Board normally meets approximately six times per year. Its direct responsibilities include setting annual budgets, reviewing trading performance, approving significant capital expenditure, ensuring adequate funding, setting and monitoring strategy, examining major acquisition possibilities and reporting to shareholders. Between meetings there is regular informal discussion between the Chairman and Chief Executive, and Finance Director and individual Non-executive Directors. The Non-executive Directors have a particular responsibility to ensure that the strategies proposed by the Executive Directors are fully considered.

To enable the Board to discharge its duties, all Directors receive appropriate and timely information. Briefing papers are distributed by the Company Secretary to all Directors in advance of Board meetings. The Chairman ensures that the Directors are able to take independent professional advice as required, at the Company's expense.

The standing committees established by the Board are the remuneration committee and audit committee, each of which operates within defined terms of reference.

A nominations committee has not been established as the Board is small. The nominations process prior to Board appointments takes into account the views of all existing Board members and some advisers. Any Director appointed to the Board since the last Annual General Meeting is required to seek re-election at the subsequent Annual General Meeting. All Directors are subject to re-election at least once every three years.

The number of meetings of the Board, and the attendance of Directors, was as follows:

Directors	No. of meetings	Attendance
John Kennair	5	5
Denis Mullan	5	5
Tudor Davies	5	5
Sir David Chapman	5	5
David Banks	5	5

Corporate governance (continued)

The workings of the Board and its committees (continued)

Remuneration committee

The remuneration committee is chaired by John Kennair, the Chairman. The other two members, Tudor Davies and Sir David Chapman, are independent Non-executive Directors. The committee is responsible for making recommendations to the Board, within agreed terms of reference, on the Company's framework of executive remuneration and its cost, including the remuneration of subsidiary Directors. The committee determines the contract terms, remuneration and other benefits for each of the Executive Directors, including performance related bonus schemes, pension rights and compensation payments. Further details of the Company's policies on remuneration, service contracts and compensation payments are given in the Remuneration report. The Chairman's remuneration is determined by a sub-committee comprising only the two independent Non-executive Directors.

The number of meetings of the committee, and the attendance of members, was as follows:

Committee members	No of meetings	Attendance
John Kennair	1	1
Tudor Davies	1	1
Sir David Chapman	1	1

Audit committee

The audit committee is chaired by Tudor Davies. He and the other member, Sir David Chapman, are both independent Non-executive Directors. Meetings are also attended, by invitation, by the other Directors. The committee meets at least twice a year. The committee provides a forum for reporting by the Group's external auditors.

The audit committee is responsible for reviewing a wide range of matters including the half year and annual financial statements before their submission to the Board and monitoring the controls which are in force to ensure the integrity of the information reported to the shareholders. The audit committee advises the Board on the appointment of external auditors and on their remuneration both for audit and non-audit work, and discusses the nature, scope and results of the audit with the auditors.

The audit committee keeps under review the cost effectiveness of the auditors. It also reviews the extent of the non-audit services provided by the auditors and reviews with them their independence and objectivity. The Chairman of the audit committee reports the outcome of audit committee meetings to the Board and the Board receives minutes of the meetings.

The number of meetings of the committee, and the attendance of members, was as follows:

Committee members	No. of meetings	Attendance
Tudor Davies	3	3
Sir David Chapman	3	3

Relations with shareholders

Communication with shareholders is given high priority. There is regular dialogue with major and/or institutional shareholders including presentations after the Company's announcements of the half year and full year results in May and December respectively. Presentations are also made to analysts and journalists at those times to present the Group's results and report on developments. This assists with the promotion of knowledge of the Group in the investment marketplace and with shareholders. The financial statements include a review of the business and future developments. These financial statements and other information relating to the Group are also available on the Group's website www.zytronic.co.uk.

Following the half year and year-end presentations of results, the Executive Directors report to the Board on the feedback received from journalists, analysts and shareholders. In addition, the Company's financial PR advisers also produce a feedback report from those meetings which is made available to all Directors. The Executive Directors also report to the Board on any meetings with shareholders or institutional investors that may take place at other times of the year.

The Board uses both the annual report and financial statements and the Annual General Meeting to communicate directly with private and institutional investors and welcomes their participation. The Chairman aims to ensure that the chairmen of the audit and remuneration committees are available at the Annual General Meeting to answer questions. Details of resolutions to be proposed at the Annual General Meeting on Tuesday 27 February 2007 can be found in the Notice of Annual General Meeting on pages 38 and 39.

In addition, the Senior Independent Director is available to shareholders if they have any concerns which contact through the normal channels of the Chairman and Chief Executive or the Finance Director has failed to resolve or for which such contact is inappropriate.

Internal control

The Board is responsible for establishing and maintaining the Group's system of internal control and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve the Group's strategic objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. As an AIM listed Company, the Company does not need to comply with Code provision C2.1 regarding the Directors giving a summary of the process applied by the Board in reviewing the effectiveness of the system of internal control. Instead, the Directors set out below some of the key aspects of the Group's internal control procedures.

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, has been established for identifying, evaluating and managing the significant risks faced by the Group. The process has been in place for the full year under review and up to the date of approval of the annual report and financial statements. The Board regularly reviews this process as part of its review of such risks within Board meetings. Where any weaknesses are identified, an action plan is prepared to address the issues and is then implemented.

The Board has overall responsibility for the Group and there is a formal schedule of matters specifically reserved for decision by the Board. Authority to operate the trading subsidiary, Zytronic Displays Limited, is delegated to its board of directors and through them it is run by its management within limits set by the Board. The appointment of Executives to the most senior positions within the Group requires the approval of the Board.

Each year the Board approves the annual budget. Key risk areas are identified, reviewed and monitored. Performance is monitored against budget, relevant action is taken throughout the year and updated forecasts are prepared as appropriate. The reports reviewed by the Board include reports on operational as well as financial issues.

Capital and development expenditure is regulated by a budgetary process and authorisation levels. For expenditure beyond specified levels, detailed written proposals have to be submitted to the Board for approval. Reviews are carried out after the purchase is complete. Major cost overruns are investigated.

Due diligence work is carried out if a business is to be acquired.

The Board has reviewed the need for an internal audit function and concluded that this is not currently necessary in view of the small size of the Group and the close supervision by senior management of its day-to-day operations.

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.

Remuneration report

As an AIM listed Company, Zytronic makes the following disclosures voluntarily and they are not intended to, and indeed do not, comply with the requirements of Schedule 7A of the Companies Act 1985.

The remuneration committee is responsible for determining the remuneration and other terms of employment for the Executive Directors of Zytronic plc and its trading subsidiary, Zytronic Displays Limited. The committee is composed of the Chairman and the two independent Non-executive Directors. In determining remuneration for the year, the committee has given full consideration to the requirements of the Combined Code.

Remuneration policy

The remuneration of Executive Directors is determined by the committee, and the remuneration of Non-executive Directors is approved by the full Board of Directors. The remuneration of the Chairman is determined by the two independent Non-executive Directors.

The key objectives of the committee in determining the remuneration packages of Executive Directors are:

- the recruitment, retention and incentivisation of executive management of the right calibre; and
- the alignment of executive management and shareholder interests.

The remuneration packages of Executive Directors comprise the following elements:

Basic salary and benefits

Basic salaries for Executive Directors are reviewed annually having regard to individual performance and market practice. In most cases benefits provided to Executive Directors comprise the provision of a company car, or appropriate allowance, and health insurance. Details of emoluments for the Directors of Zytronic plc are set out on page 17.

Annual bonus

A discretionary bonus may be awarded by the remuneration committee to reward exceptional individual performance.

Share options

The Company believes that share ownership by Executive Directors and employees strengthens the link between their personal interests and those of the Company and the shareholders.

The Company has executive share option schemes, which are designed to promote long term improvement in the performance of the Group, sustained increase in shareholder value and clear linkage between executive reward and the Group's performance. The share options of the Directors of Zytronic plc are set out on page 18.

It will normally be the case that, on the option holder ceasing employment with the Group, the options will be terminated. In some circumstances, the Board may have discretion to waive this where the past contribution to the business by the option holder justifies it.

The Company also has a Sharesave option scheme. Membership is open to all eligible employees, including Directors, who have more than six months' employment with the Group at the time options are offered under a scheme. During the year, the 2003 Sharesave Scheme reached maturity for those employees saving under the three year term. All the relevant employees exercised their options. The scheme continues for two employees who are saving under the five year term.

In compliance with the Combined Code the Board has agreed that it will not grant share options to Non-executive Directors.

Service contracts

John Kennair and Denis Mullan each has a service contract with a notice entitlement of six months.

The committee considers the Directors' notice entitlements to be appropriate as they are in line with the market and take account of the Directors' knowledge and experience. There are no special provisions for predetermined compensation in the event of loss of office.

Non-executive Directors

The fees of the Non-executive Directors are determined by the full Board within the limits set out in the Memorandum and Articles of Association. The Non-executive Directors are not eligible for bonuses, pension benefits or share options.

Directors' emoluments

Emoluments of the Directors for the year to 30 September 2006 are:

	Salary £'000	Fees £'000	Benefits £'000	**Total emoluments* 2006 £'000**	Total emoluments* 2005 £'000
Chairman					
John Kennair MBE	77	—	—	**77**	75
Executive					
Denis Mullan	73	—	10	**83**	89
Non-executive					
Tudor Davies	—	21	—	**21**	18
Sir David Chapman, Bt	—	21	—	**21**	18
David Banks**	—	21		**21**	18
	150	63	10	**223**	218

* excluding pension contributions

** fees are paid to David Banks Associates, a partnership in which David Banks is a partner

Payment to a former Director

The Company, in its 2005 annual report and financial statements and its 2006 interim statement, disclosed litigation with Ian Lawson, a former Group Chief Executive Officer. All claims by Ian Lawson, whether actual or potential, have now been settled fully and finally by the Company making a severance payment of £10,000 to him and treating, as it is entitled to do, his options under the Company's Enterprise Management Incentive EMI Scheme ("the Scheme") as not having lapsed.

Mr Lawson exercised his options under the Scheme and, pursuant to this exercise, the Company allotted 142,857 ordinary shares of 1p each in the Company to him in July 2006. The options were granted at 70p and the share price at the date of exercise was 260.5p. This resulted in a "gain" for remuneration purposes of £272,143.

Pension contributions

During the year, the Group made annual pension contributions for Denis Mullan, an Executive Director, to a personal pension scheme i.e. a defined contribution scheme. Neither benefits in kind nor bonuses are pensionable.

Details of contributions payable by the Company are:

Director	**2006 £'000**	2005 £'000
Denis Mullan	**2**	2

Directors' shareholdings

Beneficial interests of the Directors in the shares of the Company, including those of their immediate families, were:

	30 September	
	2006 No.	2005 No.
John Kennair MBE	**2,347,519**	2,347,519
Denis Mullan	**110,000**	110,000
Tudor Davies	**256,818**	256,818
Sir David Chapman, Bt	**30,000**	30,000
David Banks	**14,545**	14,545

There has been no change in Directors' shareholdings since 30 September 2006.

Remuneration report (continued)

Directors' share options

	30 September 2005 No.	Granted during year No.	Exercised during year No.	**30 September 2006 No.**	Exercise dates	Option price
Enterprise Management Incentive Scheme ("EMI")						
Denis Mullan	100,000	—	—	**100,000**	15 March 2006 to 15 March 2014	70p
Ian Lawson	142,857	—	142,857	—		
Denis Mullan	17,182	—	—	**17,182**	18 January 2008 to 17 January 2015	145.5p

During the year to 30 September 2006, the highest share price was 318p and the lowest share price was 240p. The market price of the shares at 30 September 2006 was 252p.

Directors' interests in material contracts

As noted above, the Company has paid Directors' fees to David Banks Associates, a partnership in which David Banks is a partner. At 30 September 2006 the amount due to David Banks Associates was £2,056 (2005: £Nil).

With this exception, no Director was materially interested either at the year-end or during the year in any contract of significance to the Group other than their employment or service contract.

Independent auditors' report to the members of Zytronic plc

We have audited the Group and parent company financial statements (the "financial statements") of Zytronic plc for the year ended 30 September 2006 which comprise the Statement of accounting policies, Group profit and loss account, Balance sheets, Group statement of cashflows and the related notes 1 to 25. These financial statements have been prepared on the basis of 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 are responsible for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards (United Kingdom Generally Accepted Accounting Practice) as 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, are properly prepared in accordance with the Companies Act 1985 and whether 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 Chairman's statement and Financial review that is cross referred 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 transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises only the Business overview, Highlights, Chairman's statement, Financial review, Directors, senior management and advisers, Corporate governance, Remuneration report, Five year summaries, Notice of Annual General Meeting and Corporate information. 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. 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 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 parent company's affairs as at 30 September 2006 and of the Group profit 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.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
Newcastle-upon-Tyne
4 January 2007

Statement of accounting policies

Basis of preparation

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

FRS 21, Events after the balance sheet date, is applicable for the Group for the first time this year. The main impact of the standard is that proposed dividends are no longer accrued for in the period to which they relate. Final dividends are now recognised when they are declared and approved at the AGM. Interim dividends are recognised when paid. The adjustment for the 30 September 2005 year-end is to reverse the accrual of the 2005 dividend which was not approved until the AGM in February 2006. The effect on the 30 September 2005 balance sheet is to reduce creditors and increase net assets by £215,000. A corresponding increase is recognised in reserves at that date. There were no proposed dividends at 30 September 2004 and therefore there is no restatement of the balance sheet as at 1 October 2004.

In addition, dividends will no longer be shown on the face of the profit and loss account but are shown as a movement directly in equity.

FRS 22, Earnings per share, is applicable for the Group for the first time this year. There has been no impact on the calculation of basic and diluted earnings per share reported for the year ended 30 September 2005.

FRS 25, Financial Instruments: Disclosure & Presentation, is also applicable for the Group for the first time this year. There has been no impact on the balance sheet or profit and loss account which would require disclosure.

Basis of consolidation

The Group results consolidate the financial statements of Zytronic plc and all of its subsidiary undertakings drawn up to 30 September 2006.

A profit and loss account is not presented for Zytronic plc as permitted by section 230 of the Companies Act 1985.

Goodwill

Positive goodwill arising on acquisitions is capitalised, classified as an asset on the balance sheet and amortised on a straight line basis over its useful economic life, up to a presumed maximum of 20 years. It is reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable. Currently goodwill is being amortised over its estimated useful life of 17 years.

If a subsidiary, associate or business is subsequently sold or closed, any goodwill arising on acquisition that has not been amortised through the profit and loss account is taken into account in determining the profit or loss on sale or closure.

Intangible assets

Intangible assets acquired separately from a business are capitalised at cost. Intangible assets acquired as part of an acquisition of a business are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets, excluding development costs, created within the business are not capitalised and expenditure is charged against profits in the year in which it is incurred. Development expenditure incurred on individual projects is carried forward when its future recoverability can be foreseen with reasonable certainty.

Intangible assets are amortised on a straight line basis over their estimated useful lives up to a maximum of 20 years. The carrying value of intangible assets is reviewed for impairment at the end of the first full year following acquisition and in other periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Intangible assets are being amortised over the following periods:

Licences	–	period of licensing agreements (10 and 17 years)
Capitalised development expenditure	–	4 to 10 years

Depreciation

Depreciation is provided on all tangible fixed assets, at rates calculated to write off the costs, less estimated residual value, of each asset evenly over its expected useful life, as follows:

Freehold land	–	Nil
Freehold property	–	50 years
Short leasehold property	–	over the term of the lease
Plant and machinery	–	varying rates between 5% and 25% per annum

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable. The expected useful lives of assets are reviewed annually.

Stocks

Stocks are stated at the lower of cost incurred in bringing each product to its present location and condition and net realisable value as follows:

Raw materials	–	purchase cost on a first-in, first-out basis
Work in progress and finished goods	–	cost of direct materials and labour plus attributable overheads based on a normal level of activity

Net realisable value is based on estimated selling price less further costs expected to be incurred to completion and disposal.

Deferred taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date, with the exception of deferred tax assets which are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. All differences are taken to the profit and loss account.

Leasing and hire purchase commitments

Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset have passed to the Company, and hire purchase contracts are capitalised in the balance sheet and are depreciated over their useful lives. The capital elements of future obligations under leases and hire purchase contracts are included as liabilities in the balance sheet. The interest elements of the rental obligations are charged to the profit and loss account over the periods of the leases and hire purchase contracts and represent a constant proportion of the balance of capital repayments outstanding.

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

Interest bearing loans and borrowings

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowings. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period.

Pensions

The Company and its subsidiaries are members of a Group personal pension scheme which is a defined contribution scheme. Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the scheme.

Group profit and loss account for the year ended 30 September 2006

	Notes	2006 £'000	2005 £'000
Group turnover	1	**12,301**	10,590
Cost of sales		**8,449**	7,312
Gross profit		**3,852**	3,278
Distribution costs		**170**	140
Administration expenses		**2,317**	2,137
		2,487	2,277
Group operating profit	2	**1,365**	1,001
Interest payable	4a	**(59)**	(33)
Interest receivable	4b	**6**	16
Profit on ordinary activities before taxation		**1,312**	984
Tax charge on profit on ordinary activities	5	**(158)**	(310)
Profit on ordinary activities after taxation		**1,154**	674
Earnings per share			
Earnings per share – basic	7	**8.0p**	4.7p
Earnings per share – diluted	7	**7.9p**	4.6p

There were no recognised gains or losses as defined in Financial Reporting Standard 3 other than those stated above. In addition, the effect of implementing Financial Reporting Standard 21 – events after the balance sheet date – is that an amount of £215,000 for the year to 30 September 2005, previously included within creditors, has been added back to the profit and loss account reserve.

The results for both the above years derive from continuing operations.

Balance sheets at 30 September 2006

		Group		Company	
		2006	2005 (restated)	**2006**	2005 (restated)
	Notes	**£'000**	£'000	**£'000**	£'000
Fixed assets					
Intangible assets	8	**2,026**	2,133	**—**	—
Tangible assets	9	**3,831**	2,494	**863**	
Investments	10	**—**	—	**9,448**	9,448
		5,857	4,627	**10,311**	9,448
Current assets					
Stocks	11	**1,706**	1,201	**—**	—
Debtors:					
– amounts falling due within one year	12	**2,852**	2,641	**1,841**	2,243
– amounts falling due after one year	12	**—**	—	**4,000**	4,000
Cash at bank and in hand		**493**	810	**610**	3
		5,051	4,652	**6,451**	6,246
Creditors: amounts falling due within one year	13	**1,837**	1,878	**242**	146
Net current assets		**3,214**	2,774	**6,209**	6,100
Total assets less current liabilities		**9,071**	7,401	**16,520**	15,548
Creditors: amounts falling due after more than one year	14	**658**	161	**658**	—
Provisions for liabilities and charges					
Deferred tax	17	**380**	239	**—**	—
		8,033	7,001	**15,862**	15,548
Capital and reserves					
Called up share capital	19	**146**	143	**146**	143
Share premium	20	**6,450**	6,215	**6,450**	6,215
Profit and loss account	20	**1,437**	643	**9,266**	9,190
Shareholders' funds		**8,033**	7,001	**15,862**	15,548

J M Kennair MBE
Chairman
4 January 2007

D G W Mullan, B.Sc, FCA
Director

Group statement of cashflows for the year ended 30 September 2006

	Notes	2006 £'000	2005 £'000
Net cash inflow from operating activities	21a	1,529	939
Return on investments and servicing of finance			
Interest received		6	16
Interest paid		(48)	(12)
Interest element of finance lease rental payments		(11)	(21)
Net outflow from returns on investments and servicing of finance		(53)	(17)
Taxation			
Corporation tax paid		(230)	(28)
Capital expenditure and financial investment			
Payments to acquire intangible fixed assets		(159)	(209)
Payments to acquire tangible fixed assets		(1,767)	(830)
Receipt from sale of assets		6	75
Net outflow from capital expenditure and financial investment		(1,920)	(964)
Equity dividends paid		(360)	(71)
Net cash outflow before financing		(1,034)	(141)
Financing			
Receipt from new bank loan		750	—
Issue of ordinary share capital		238	3
Repayments of bank loans		(122)	(83)
Repayments of capital element of finance lease		(149)	(140)
Net inflow/(outflow) from financing		717	(220)
Decrease in cash		(317)	(361)
Reconciliation of net cashflow to movement in net (debt)/funds			
Decrease in cash		(317)	(361)
Receipt from new bank loan		(750)	—
Repayments of bank loans		122	83
Repayments of capital element of finance lease		149	140
Movement in net (debt)/funds		(796)	(138)
Net funds at beginning of year		416	554
Net (debt)/funds at end of year	21b	(380)	416

Notes to the financial statements for the year ended 30 September 2006

1. Group turnover

Turnover represents the invoiced amount of goods sold and services provided, stated net of value added tax.

The Group operates in one continuing area of activity – the development and manufacture of customised optical filters to enhance electronic display performance – increasingly touch sensors. All turnover, profits or losses before tax and net assets are attributable to this business segment.

All manufacturing takes place in the UK and the analysis of the destination of turnover by geographical market is given below:

	2006 £'000	2005 £'000
UK	**4,623**	4,447
USA and Canada	**3,823**	3,064
Western Europe	**2,740**	2,482
Rest of the World	**1,115**	597
	12,301	10,590

2. *Group operating profit*

This is stated after charging:

	2006 £'000	2005 £'000
Auditors' remuneration – in respect of audit services*	**34**	30
– in respect of taxation services	**40**	28
Depreciation of owned assets	**384**	370
Depreciation of assets held under finance lease	**45**	57
Amortisation of goodwill and licences	**136**	136
Hire of plant and machinery	**1**	1
Operating lease rentals – plant, machinery and vehicles	**35**	34
– land and buildings	**224**	225
Research and development costs	**135**	169
Amortisation of development expenditure	**130**	110

* £16,000 of this relates to the Company (2005: £12,000).

3. Staff costs (including Directors)

	2006 £'000	2005 £'000
Wages and salaries	**3,103**	2,899
Social security costs	**298**	260
Other pension costs	**32**	34
	3,433	3,193

The total of Directors' emoluments is set out in the Remuneration report. The aggregate value of contributions paid to money purchase pension schemes includes £2,000 (2005: £2,000) in respect of one Director (2005: one).

The average number of employees during the year was made up as follows:

	2006 No.	2005 No.
Production	**147**	146
Administration and sales	**35**	31
	182	177

The information required by Schedule 6 of the Companies Act is contained in the Remuneration report under Directors' emoluments, Payment to a former Director, Pension contributions, Directors' shareholdings, and Directors' share options.

Notes to the financial statements for the year ended 30 September 2006 (continued)

4. Interest

(a) Interest payable

	2006 £'000	2005 £'000
Finance charges payable under finance lease	11	21
Bank loans and overdrafts	48	12
	59	33

(b) Interest receivable

	2006 £'000	2005 £'000
Bank	6	16

5. Tax charge on profit on ordinary activities

	2006 £'000	2005 £'000
Current tax:		
UK corporation tax	(27)	(251)
Corporation tax over-provided in prior years	10	8
Total current tax	(17)	(243)
Deferred tax:		
Origination and reversal of timing differences	(141)	(67)
Group deferred tax	(141)	(67)
Tax charge on profit on ordinary activities	(158)	(310)

Factors affecting current tax charge:

	2006 £'000	2005 £'000
Profit on ordinary activities multiplied by standard rate of UK corporation tax of 30% (2005: 30%)	(394)	(295)
Expenses not deductible for tax purposes (includes amortisation of goodwill and licences)	(42)	(86)
Deferred revenue expenses and tax credits	110	47
Accelerated capital allowances	81	67
Effects of small company/marginal rates of UK corporation tax	16	16
"Gain" on exercise of share options allowable for taxation purposes but not reflected in the profit and loss account	202	-
Adjustments in respect of prior years	10	8
Total current tax	(17)	(243)

Factors that may affect future tax charges:
Under current tax legislation, some of the amortisation of goodwill and licences will continue to be non-deductible for tax purposes.

Under the Inland Revenue's R&D tax credit scheme, the Group will receive an annual uplift of 50% on qualifying R&D expenditure for tax purposes. Until the current year, where R&D expenditure has been capitalised, the benefit of this uplift is only recognised as the asset is amortised. The unrecognised element at 30 September 2006 was £120,000 (2005: £170,000). Following changes to Inland Revenue rules, the uplift on expenditure which has been capitalised in the current year is recognised in the current year.

The "gain" on the exercise of share options, being the difference between the grant/exercise price and the market value at the time of exercise, is allowable as a taxable deduction from profits although it is not reflected within the profit and loss account. These gains will arise in future years but their timing and amount is uncertain. It is likely that they will not be as significant as in the current year due to the lower quantities, and spread of exercise dates, of outstanding options.

6. Dividends

The Directors propose the payment of a final dividend of 2.0p per share (2005: 1.5p), payable on 16 March 2007 to shareholders on the Register on 2 March 2007. As stated in note 1 above, this dividend has not been accrued in these Annual Accounts. The dividend payment will amount to some £295,000.

Under Financial Reporting Standard 21 the dividends in the current and prior year have been restated as follows:

	2006 £'000	2005 (restated) £'000
Ordinary dividends on equity shares		
Interim dividend of 0.5p per ordinary share paid on 29 June 2005	—	71
Final dividend of 1.5p per ordinary share paid on 24 March 2006	215	—
Interim dividend of 1.0p per ordinary share paid on 30 June 2006	145	—
	360	71

7. Earnings per share

Basic earnings per share (EPS) is calculated by dividing the profit attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares in issue during the year. All activities are continuing operations and therefore there is no difference between EPS arising from total operations and EPS arising from continuing operations.

	Earnings 30 September 2006 £'000	Weighted average number of shares 30 September 2006 thousands	Earnings per share 30 September 2006 pence	Earnings 30 September 2005 £'000	Weighted average number of shares 30 September 2005 thousands	Earnings per share 30 September 2005 pence
Profit on ordinary activities after taxation attributable to ordinary equity holders	1,154	14,414	8.0	674	14,292	4.7
Basic EPS	1,154	14,414	8.0	674	14,292	4.7

The weighted average number of shares for diluted EPS is calculated by including the weighted average number of shares under option.

	Earnings 30 September 2006 £'000	Weighted average number of shares 30 September 2006 thousands	Earnings per share 30 September 2006 pence	Earnings 30 September 2005 £'000	Weighted average number of shares 30 September 2005 thousands	Earnings per share 30 September 2005 pence
Profit on ordinary activities after taxation attributable to ordinary equity holders	1,154	14,414	8.0	674	14,292	4.7
Weighted average number of shares under option	—	220	(0.1)	—	302	(0.1)
Diluted EPS	1,154	14,634	7.9	674	14,594	4.6

8. Intangible fixed assets

Group	Goodwill £'000	Licences £'000	Development expenditure £'000	Total £'000
Cost:				
At 1 October 2005	366	1,970	1,040	3,376
Additions	—	5	154	159
At 30 September 2006	366	1,975	1,194	3,535
Amortisation:				
At 1 October 2005	110	619	514	1,243
Provided during the year	21	115	130	266
At 30 September 2006	131	734	644	1,509
Net book value at 30 September 2006	235	1,241	550	2,026
Net book value at 30 September 2005	256	1,351	526	2,133

Notes to the financial statements for the year ended 30 September 2006 (continued)

9. Tangible fixed assets

Group	Land £'000	Freehold property £'000	Short leasehold property £'000	Plant and machinery £'000	Total £'000
Cost:					
At 1 October 2005	—	—	26	7,886	7,912
Additions	100	768	135	765	1,768
Disposals	—	—	—	(1,414)	(1,414)
At 30 September 2006	**100**	**768**	**161**	**7,237**	**8,266**
Depreciation:					
At 1 October 2005	—	—	6	5,412	5,418
Provided during the year	—	5	5	419	429
Disposals	—	—	—	(1,412)	(1,412)
At 30 September 2006	**—**	**5**	**11**	**4,419**	**4,435**
Net book value at 30 September 2006	**100**	**763**	**150**	**2,818**	**3,831**
Net book value at 30 September 2005	—	—	20	2,474	2,494

Included in the amounts for plant and machinery are the following amounts relating to assets acquired under a finance lease:

	2006 £'000	2005 £'000
Cost	**684**	684
Accumulated depreciation	**286**	241

Company	Land £'000	Freehold property £'000	Total £'000
Cost:			
At 1 October 2005	—	—	—
Additions	100	768	868
Disposals	—	—	—
At 30 September 2006	**100**	**768**	**868**
Depreciation:			
At 1 October 2005	—	—	—
Provided during the year	—	5	5
Disposals	—	—	—
At 30 September 2006	**—**	**5**	**5**
Net book value at 30 September 2006	**100**	**763**	**863**
Net book value at 30 September 2005	—	—	—

10. Investments

Investments in subsidiary companies

	Company	
	2006 **£'000**	2005 £'000
Shares in subsidiary companies:		
At beginning and end of year	**9,448**	9,448

Details of the investments in which the Company holds 20% or more of the nominal value of any class of share capital are as follows:

Name of company	Holding	Proportion of voting rights and shares held	Nature of business
Zytronic Displays Limited	Ordinary shares	100%	Manufacture of transparent composites, including touch sensors
Intasolve Limited	Ordinary shares	100%	Dormant
Zytronic Glass Products Limited	Ordinary shares	100%	Dormant

The operating subsidiary is incorporated in England.

11. Stocks

	Group	
	2006 **£'000**	2005 £'000
Raw materials and consumables	**1,042**	660
Work in progress	**463**	370
Finished goods	**201**	171
	1,706	1,201

The difference between purchase price or production cost of stocks and their replacement cost is not material.

12. Debtors

	Group		Company	
	2006 **£'000**	2005 £'000	**2006** **£'000**	2005 £'000
Trade debtors	**2,610**	2,060	—	
Amounts owed by Group undertakings	—	—	**5,827**	6,180
Other debtors	—	—	**13**	48
Prepayments and accrued income	**242**	581	**1**	15
	2,852	2,641	**5,841**	6,243

Amounts falling due after more than one year included above are:

	Group		Company	
	2006 **£'000**	2005 £'000	**2006** **£'000**	2005 £'000
Amounts owed by Group undertakings	—		**4,000**	4,000

Notes to the financial statements for the year ended 30 September 2006 (continued)

13. Creditors: amounts falling due within one year

As explained in the Statement of accounting policies, FRS 21, Events after the balance sheet date, is applicable for the Group for the first time this year. The main impact of the standard is that proposed dividends are no longer accrued for in the period to which they relate. Final dividends are now recognised when they are declared and approved at the AGM. Interim dividends are recognised when paid. The adjustment for the 30 September 2005 year-end is to reverse the accrual of the 2005 dividend which was not approved until the AGM in February 2006. The effect on the 30 September 2005 balance sheet is to reduce creditors and increase net assets by £215,000. A corresponding increase is recognised in reserves at that date. There were no proposed dividends at 30 September 2004 and therefore there is no restatement of the balance sheet as at 1 October 2004.

	Group		Company	
	2006	2005 (restated)	**2006**	2005 (restated)
	£'000	£'000	**£'000**	£'000
Bank loan (note 15a)	**83**	84	**—**	—
Bank loan (note 15b)	**54**	—	**54**	—
Obligations under finance lease (note 16a)	**78**	149	**—**	—
Trade creditors	**1,065**	1,077	**52**	23
Corporation tax	**28**	238	**41**	42
Other taxes and social security costs	**102**	77	**—**	
Other creditors and accruals	**427**	253	**14**	—
Other amounts owed to subsidiary undertakings	**—**	—	**81**	81
	1,837	1,878	**242**	146

14. Creditors: amounts falling due after more than one year

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Bank loan (note 15a)	**—**	83	**—**	—
Bank loan (note 15b)	**658**	—	**658**	—
Obligations under finance lease (note 16a)	**—**	78	**—**	
	658	161	**658**	—

15. Bank loans

(a) On 28 September 2004, Zytronic Displays Limited entered into a secured term loan with Yorkshire Bank PLC under which it borrowed £250,000, repayable in 36 equal monthly instalments. The loan is secured by a chattel mortgage over certain items of plant and machinery. Interest is payable at 1% above that bank's base rate. The loan has been guaranteed by Zytronic plc.

(b) On 13 January 2006, Zytronic plc drew down funds under a ten year mortgage with Lloyds TSB Bank plc under which it borrowed £750,000, repayable by monthly instalments. The loan is secured against its freehold interest in Britannia Court, adjoining factory premises which it acquired in January 2006, see note 9. Interest is payable at 1.25% above that bank's base rate.

16. Obligations under leases

(a) Obligations under finance lease

	Group	
	2006 £'000	2005 £'000
Amounts payable:		
Within one year	**80**	159
In two to five years inclusive	**—**	80
	80	239
Less: finance charges allocated to future years	**2**	12
	78	227
Shown as:		
Current obligations (note 13)	**78**	149
Non-current obligations (note 14)	**—**	78
	78	227

16. Obligations under leases (continued)

(b) Obligations under operating leases

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

	Land and buildings		Other	
Group	**2006 £'000**	2005 £'000	**2006 £'000**	2005 £'000
Operating leases which expire:				
Within one year	**—**	—	**10**	10
In two to five years inclusive	**—**	—	**23**	10
Over five years	**224**	224	**—**	—
	224	224	**33**	20

17. Deferred taxation

The deferred tax included in the balance sheet is as follows:

Group	**2006 £'000**	2005 £'000
Accelerated capital allowances	**380**	239
At 1 October	**239**	172
Charged in profit and loss account	**141**	67
At 30 September	**380**	239

18. Financial risk management policy and financial instruments

The Group has taken advantage of the exemption to exclude short term debtors and creditors from the disclosures given below other than currency exposures.

The Group's principal financial instruments comprise a finance lease, two secured bank loans and cash. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial instruments, such as trade debtors and trade creditors, that arise directly from its operations.

The main risks associated with the Group's financial assets and liabilities are set out below.

Price risk

There is no significant exposure to changes in the carrying value of financial liabilities because all of these bear interest at floating rates.

Credit risk

The risk of financial loss due to a counterparty's failure to honour its obligations arises principally in relation to transactions where the Group provides goods on deferred terms.

Group policies are aimed at minimising such losses, and require that deferred terms are granted only to customers who demonstrate an appropriate payment history and/or satisfy creditworthiness procedures. Individual exposures are monitored with customers subject to credit limits to ensure that the Group's exposure to bad debts is not significant. Goods may be sold on a cash-with-order basis to mitigate credit risk.

Liquidity risk

The Company aims to mitigate liquidity risk by managing cash generated by its operations. Capital expenditure is approved at Group level. Flexibility is maintained by retaining surplus cash in readily accessible bank accounts.

Foreign exchange risk

The Group's policy is that no trading in financial instruments should be undertaken. Spot contracts and forward currency contracts may be used to sell surplus US Dollars and Euros, generated from sales less purchases in those currencies. However the Group uses natural hedging as the main basis of minimising its exposure to these currencies.

The Group has not sought to tie itself into fixed rate debt but has instead accepted a degree of interest rate risk from having only floating rate debt. This is because the Group has positive cash balances, a low level of borrowings and estimates that an increase of 1% in interest rates would not have a material effect on the Group's pre-tax profits.

At the year-end the Group has net cash balances of £493,000 and borrowings of £873,000 (2005: cash £810,000; borrowings £394,000).

The main risks arising from the Group's financial instruments are as follows:

- foreign currency risk – the magnitude of this risk that has arisen over the period is detailed below; and
- interest rate risk on floating rate financial liabilities to the extent not covered by interest rate benefit on floating rate financial assets – details of floating rate financial liabilities and assets are on page 32.

Notes to the financial statements for the year ended 30 September 2006 (continued)

18. Financial risk management policy and financial instruments (continued)

Interest rate risk

Interest rate risk profile of financial liabilities

	Floating rate financial liabilities £'000	Total £'000
30 September 2006	**873**	**873**
30 September 2005	394	394

Interest rate risk profile of financial assets

	Floating rate financial assets £'000	Total £'000
30 September 2006	**493**	**493**
30 September 2005	810	810

The floating rate financial assets comprise cash. The benchmarks for floating rates on both liabilities and assets is LIBOR and Bank of England base rate.

Currency exposures

The table below shows the Group's currency exposures; in other words, those transactional exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating currency of the Group.

These currency exposures were:

	Net foreign currency monetary assets/(liabilities)		
	US Dollar £'000	Euro £'000	Total £'000
30 September 2006	**794**	**454**	**1,248**
30 September 2005	539	402	941

The year-end net foreign currency monetary assets comprise cash and trade debtor balances less trade creditor balances. These are the inherent constituents of the natural hedging policy whereby foreign currency sales are turned into cash for the settlement of purchases of goods denominated in those foreign currencies. Cash at a month end is held to settle creditors' payments due in the next two months and to meet future anticipated capital expenditure in those currencies.

Maturity profile of financial liabilities

	2006 £'000	2005 £'000
In one year or less, or on demand	**215**	233
In more than one year but not more than two	**57**	161
In more than two years but not more than five	**196**	—
In more than five years but not more than ten	**405**	
	873	394

Borrowing facilities

The Group has an unsecured overdraft facility of £750,000 arranged with its principal banker, Lloyds TSB Bank plc. This facility extends until 28 February 2007.

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of book values and fair values of the Group's financial assets and financial liabilities excluding short term debtors and creditors:

	Book value		Fair value	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Cash	**493**	810	**493**	810
Current portion of long term borrowings	**(215)**	(233)	**(215)**	(233)
Long term borrowings	**(658)**	(161)	**(658)**	(161)

Fair values of floating rate financial liabilities have been calculated by discounting the expected future cashflows at prevailing interest rates.

19. Share capital

Group and Company	2006 '000	2005 '000	2006 £'000	2005 £'000
Authorised:				
Ordinary shares of 1p each	**25,000**	25,000	**250**	250
Allotted, called up and fully paid:				
Ordinary shares 1p each	**14,640**	14,300	**146**	143

During the year the Company had four share option schemes, the Approved Executive Option Scheme, the Unapproved Executive Option Scheme, an Enterprise Management Incentive ("EMI") Scheme and a Sharesave Scheme. Under these schemes, options to subscribe for the Company's shares have been granted as follows:

	30 September 2005 No.	Granted during year No.	Exercised during year No.	Lapsed during year No.	30 September 2006 No.	Exercise dates	Option price
Unapproved Executive Scheme	135,452	—	77,271	—	**58,181**	7 June 2003 to 7 June 2010	110p
Sharesave Scheme (2003)	132,206	—	120,262	—	**11,944**	1 April 2006 to 30 September 2008	44p
EMI Scheme*	242,857	—	142,857		**100,000**	16 March 2006 to 15 March 2014	70p
	91,408	—	—	—	**91,408**	18 January 2008 to 17 January 2015	145.5p
	-	87,250	—	—	**87,250**	11 January 2009 to 10 January 2016	274.5p

Performance conditions have not been attached to the share options awarded under the EMI Scheme.

The Company has taken advantage of the exemption offered under UITF 17 for Inland Revenue approved save as you earn schemes.

During the year 77,271; 120,262 and 142,857 ordinary shares with a combined aggregate nominal value of £3,404 were allocated for cash at 110p; 44p and 70p respectively each on the exercise of one or more options.

* The exercise of 142,857 options under the EMI scheme is explained within the Payment to a former Director section of the Remuneration report.

20. Reconciliation of movements in shareholders' funds

As explained in the Statement of accounting policies, FRS 21, Events after the balance sheet date, is applicable for the Group for the first time this year. The main impact of the standard is that proposed dividends are no longer accrued for in the period to which they relate. Final dividends are now recognised when they are declared and approved at the AGM. Interim dividends are recognised when paid. The adjustment for the 30 September 2005 year-end is to reverse the accrual of the 2005 dividend which was not approved until the AGM in February 2006. The effect on the 30 September 2005 balance sheet is to reduce creditors and increase net assets by £215,000. A corresponding increase is recognised in reserves at that date. There were no proposed dividends at 30 September 2004 and therefore there is no restatement of the balance sheet as at 1 October 2004.

Group	Called up share capital £'000	Share premium £'000	Profit and loss account £'000	Total £'000
At 1 October 2004	143	6,212	40	6,395
Exercise of share options		3	—	3
Profit on ordinary activities after taxation	—	—	674	674
Dividends (restated)	—	—	(71)	(71)
At 30 September 2005 – as restated	143	6,215	643	7,001
Exercise of share options	3	235		238
Profit on ordinary activities after taxation	—	—	1,154	1,154
Dividends	—		(360)	(360)
At 30 September 2006	**146**	**6,450**	**1,437**	**8,033**

Notes to the financial statements for the year ended 30 September 2006 (continued)

20. Reconciliation of movements in shareholders' funds (continued)

Company	Called up share capital £'000	Share premium £'000	Profit and loss account £'000	Total £'000
At 1 October 2004	143	6,212	9,115	15,470
Exercise of share options	—	3		3
Profit on ordinary activities after taxation	—	—	146	146
Dividends (restated)		—	(71)	(71)
At 30 September 2005 – as restated	143	6,215	9,190	15,548
Exercise of share options	3	235	—	238
Profit on ordinary activities after taxation	—	—	436	436
Dividends	—	—	(360)	(360)
At 30 September 2006	**146**	**6,450**	**9,266**	**15,862**

A profit of £436,000 (2005: £146,000), before payments of dividends of £360,000 (2005 restated: £71,000), has been dealt with in the financial statements of the Company which, under the exemption contained in section 230 of the Companies Act 1985, has not presented its own profit and loss account.

Included in the Company's opening and closing profit and loss account reserves is an amount of £8,919,000 which was a dividend received from a subsidiary company in a prior year. This is not included in Group reserves and does not form part of the Company's distributable reserves.

21. Notes to the statement of Group cashflows

(a) Reconciliation of operating profit to net cash inflow from operating activities

	2006 £'000	2005 £'000
Operating profit	**1,365**	1,001
Depreciation	**429**	427
Amortisation	**266**	246
Profit on sale of fixed assets	**(5)**	—
Gross cash inflows	**2,055**	1,674
Increase in stocks	**(505)**	(117)
Increase in debtors	**(216)**	(767)
Increase in creditors	**195**	149
Net cash inflow from operating activities	**1,529**	939

(b) Analysis of net funds/(debt)

	2005 £'000	Cashflows £'000	2006 £'000
Cash at bank and in hand	810	(317)	**493**
Bank loan (note 15a)	(167)	84	**(83)**
Bank loan (note 15b)	—	(712)	**(712)**
Finance lease (note 16a)	(227)	149	**(78)**
Net funds/(debt)	416	(796)	**(380)**

22. Capital commitments

Amounts contracted for at 30 September 2006 but not provided in the financial statements amounted to Nil (2005: £541,000) for the Group and Nil (2005: £Nil) for the Company.

23. Pension scheme commitments

Contributions for the year to 30 September 2006 amounted to £32,000 (2005: £34,000) and the outstanding contributions at the balance sheet date were £6,000 (2005: £2,000).

24. Related party transactions

Related party transactions are dealt with under the heading Directors' interests in material contracts in the Remuneration report. There are not any other related party transactions required to be disclosed in the financial statements.

25. Contingent liabilities

Zytronic plc has given a guarantee to Yorkshire Bank PLC in connection with the bank loan detailed in note 15a and to Lloyds TSB Bank plc in connection with the overdraft facility detailed in note 13.

Five year summaries

Group profit and loss accounts

for the five years ended 30 September 2002 to 2006

	2006 £'000	2005 £'000	2004 £'000	2003 £'000	2002 £'000
Group turnover	**12,301**	10,590	8,756	5,690	5,066
Cost of sales	**8,449**	7,312	6,187	4,075	3,678
Gross profit	**3,852**	3,278	2,569	1,615	1,388
Distribution costs	**170**	140	121	80	66
Administration expenses:					
before exceptional item	**2,317**	2,137	2,078	1,801	1,716
– exceptional reorganisation costs	–			87	
Total administration costs	**2,317**	2,277	2,078	1,888	1,716
	2,487	2,277	2,199	1,968	1,782
Group operating profit/(loss)	**1,365**	1,001	370	(353)	(394)
Interest payable	**(59)**	(33)	(26)	(35)	(33)
Interest receivable	**6**	16	6	22	21
Profit/(loss) on ordinary activities before taxation	**1,312**	984	350	(366)	(406)
Tax (charge on profit)/credit on loss on ordinary activities	**(158)**	(310)	(114)	59	85
Profit/(loss) on ordinary activities after taxation	**1,154**	674	236	(307)	(321)
Earnings per share					
Earnings/(loss) per share – basic	**8.0p**	4.7p	1.7p	(2.1)p	(2.2)p
Earnings/(loss) per share – diluted	**7.9p**	4.6p	1.6p	(2.1)p	(2.2)p

There were no recognised gains or losses as defined in Financial Reporting Standard 3 other than those stated above.

The results for all the above years derive from continuing operations.

Group balance sheets
as at 30 September 2002 to 2006

	2006 £'000	2005 (restated) £'000	2004 £'000	2003 £'000	2002 £'000
Fixed assets					
Intangible assets	**2,026**	2,133	2,172	2,235	2,357
Tangible assets	**3,831**	2,494	2,155	2,258	2,630
	5,857	4,627	4,327	4,493	4,987
Current assets					
Short term property investment	**—**	—	75	75	—
Stocks	**1,706**	1,201	1,084	1,086	895
Debtors: amounts falling due within one year	**2,852**	2,641	1,873	1,134	1,259
Cash at bank and in hand	**493**	810	1,171	954	1,176
	5,051	4,652	4,203	3,249	3,330
Creditors: amounts falling due within one year	**1,837**	1,878	1,569	1,126	1,203
Net current assets	**3,214**	2,774	2,634	2,123	2,127
Total assets less current liabilities	**9,071**	7,401	6,961	6,616	7,114
Creditors: amounts falling due after more than one year	**658**	161	394	367	499
Provisions for liabilities and charges					
Deferred tax	**380**	239	172	90	149
	8,033	7,001	6,395	6,159	6,466
Capital and reserves					
Called up share capital	**146**	143	143	143	143
Share premium	**6,450**	6,215	6,212	6,212	6,212
Merger reserve	**—**	—	—	—	(31)
Profit and loss account	**1,437**	643	40	(196)	142
Shareholders' funds	**8,033**	7,001	6,395	6,159	6,466

The 2005 balance sheet was restated to reflect the requirements of Financial Reporting Standard 21. It does not have any effect on the figures in the prior years.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of the Company will be held at the Company's offices at Patterson Street, Blaydon-on-Tyne, Tyne & Wear NE21 5SG on Tuesday 27 February 2007 at 2.00pm for the following purposes:

Ordinary business

To consider and, if thought fit, to pass the following resolutions as ordinary resolutions of the Company:

1. To receive the financial statements for the year ended 30 September 2006 and the reports of the Directors and auditors thereon.
2. To pay a final dividend of 2.0p per ordinary share of 1.0p for the year ended 30 September 2006 on 16 March 2007 to members on the Register at the close of business on 2 March 2007.
3. To re-elect David Banks as a Director.
4. To re-elect Tudor Davies as a Director.
5. To re-appoint Ernst & Young LLP as auditors and to authorise the Directors to fix their remuneration.

Special business

To consider and, if thought fit, to pass the following resolutions as special resolutions of the Company:

1. The Directors of the Company be and are hereby generally and unconditionally authorised (in substitution for any previous authority) for the purposes of section 80 of the Companies Act 1985 (as amended) (the "Act") to exercise all the powers of the Company to allot relevant securities (as defined in section 80(2) of the Act) on such terms and in such manner as they shall think fit, up to an aggregate nominal value equal to £48,801.20 at any time (unless and to the extent previously revoked, varied or renewed by the Company in general meeting) during the period from the date hereof until the conclusion of the Company's Annual General Meeting held in 2008 provided that the Directors of the Company may make an offer or enter into an agreement which would or might require relevant securities to be allotted after the expiry of such authority and the Directors may allot relevant securities after such expiry under this authority in pursuance of any such offer or agreement as if this authority had not expired. The authority hereby given may at any time (subject to the provisions of section 80 of the Act) be renewed, revoked or varied by ordinary resolution of the Company in general meeting.
2. The Directors of the Company be given power pursuant to section 95 of the Act to allot equity securities (as defined in section 94 of the Act) for cash pursuant to the section 80 authority, referred to above in resolution 1, as if section 89(1) of the Act did not apply to any such allotment, such power to expire at the conclusion of the Company's Annual General Meeting held in 2008 or, if earlier, the revocation of the section 80 authority referred to above provided that before such expiry the Directors of the Company may make an offer or enter into an agreement which would or might require equity securities to be allotted after the expiry of such power and the Directors may allot equity securities after such expiry under this power in pursuance of any such offer or agreement as if this power had not expired. The power is limited to:

   2.1 the allotment of equity securities for cash in connection with a rights issue to holders of ordinary shares of 1.0p each where the equity securities respectively attributable to the interests of such holders are proportionate (as nearly as may be practicable) to the respective numbers of ordinary shares of 1.0p each held by them but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with any fractional entitlements or any legal or practical problems under the laws of, or the requirements of any regulatory body or any recognised stock exchange in, any territory; and

   2.2 the allotment (other than pursuant to 2.1 of this special resolution) of equity securities up to a maximum aggregate nominal amount of £14,640.36.

   This power applies in relation to any sale of shares which is an allotment of equity securities by virtue of section 94(3A) of the Act as if in the first paragraph of this resolution the words "pursuant to the section 80 authority, referred to above in resolution 1," were omitted.

Special business (continued)

3. That the Company be and is hereby generally and unconditionally authorised in accordance with section 166 of the Act to make market purchases (within the meaning of section 163 of the Act) of ordinary shares of 1.0p each in the capital of the Company ("Shares") provided that:

   3.1 the maximum number of Shares hereby authorised to be purchased shall be 1,464,036;

   3.2 the minimum price which may be paid for a Share shall be 1.0p;

   3.3 the maximum price which may be paid for a Share shall be not more than 5% above the average of the middle market quotations for Shares on AIM for the five business days immediately preceding the date of the purchase of the Share; and

   3.4 unless previously varied, revoked or renewed, the authority hereby conferred shall expire at the conclusion of the Company's Annual General Meeting held in 2008 save that the Company may prior to such expiry enter into a contract to purchase Shares which will or may be executed wholly or partly after such expiry and purchase Shares pursuant to such contract;

   and that all Shares so purchased in pursuance of this authority shall be held as Treasury Shares (as defined by section 162A of the Act) for future resale for cash; transfer for the purposes of an employees' share scheme; or for cancellation.

By order of the Board

D G W Mullan, B.Sc. FCA
Company Secretary
Zytronic plc
Patterson Street
Blaydon-on-Tyne
Tyne & Wear
NE21 5SG
4 January 2007

Notes:

1. Every member entitled to attend and vote at the meeting may appoint a proxy or proxies to attend and on a poll vote on their behalf. A proxy need not be a member of the Company. A prepaid form of proxy is enclosed. Completed forms of proxy must be returned to the Company's Registrars at the address shown on the form of proxy not less than 48 hours before the time appointed for the holding of the meeting. The sending of a completed form of proxy to the Company's Registrars will not preclude members from attending and voting at the meeting, or any adjournment thereof, in person, should they so wish.

2. The Company, pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those holders of ordinary shares of 1.0p each of the Company registered in the Register of Members of the Company as at 2.00pm on Friday 23 February 2007 shall be entitled to attend or vote at the meeting in respect of the number of ordinary shares of 1.0p each of the Company registered in their name at that time. Changes to entries on the register of members after 2.00pm on Friday 23 February 2007 shall be disregarded in determining the rights of any person to attend or vote at the meeting.

3. Copies of contracts of service between Directors and the Company or any of its subsidiary undertakings, together with the Register of Directors' share interests, will be available for inspection during normal business hours by members at the registered office of the Company on each business day from the date of this notice until the date of the Annual General Meeting, and at the place of the Annual General Meeting for at least 15 minutes prior to, and during, that meeting.

Corporate information

Board of Directors

John Martin Kennair MBE
Chairman and Chief Executive

Denis Gerald Wilson Mullan B.Sc, FCA
Finance Director

Tudor Griffith Davies B.Sc
Senior Independent Non-executive Director

Sir David Robert Macgowan Chapman Bt., DL, B Comm
Independent Non-executive Director

David Eric Banks MA (Cantab), FCA
Non-executive Director and Deputy Chairman

Key senior management of Zytronic Displays Limited

Mark Cambridge
Managing Director

Dave Carr
Production Director

Dr Andrew Morrison Ph.D., MIEE, MIEEE
Technical Director

Website

www.zytronic.co.uk

Secretary

Denis G W Mullan FCA
Email: denis.mullan@zytronic.co.uk

Registered office

Patterson Street
Blaydon-on-Tyne
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Telephone: 0191 414 5511
Fax: 0191 414 0545

Registration number

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Glasgow
G2 5TS

Registrars

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Bristol
BS99 7NH

Bankers

Lloyds TSB Bank Plc
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Black Horse House
91 Sandyford Road
Newcastle-upon-Tyne
NE99 1JW

Auditors

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Citygate
St James' Boulevard
Newcastle-upon-Tyne
NE1 4JD

Solicitors

Ward Hadaway
Sandgate House
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