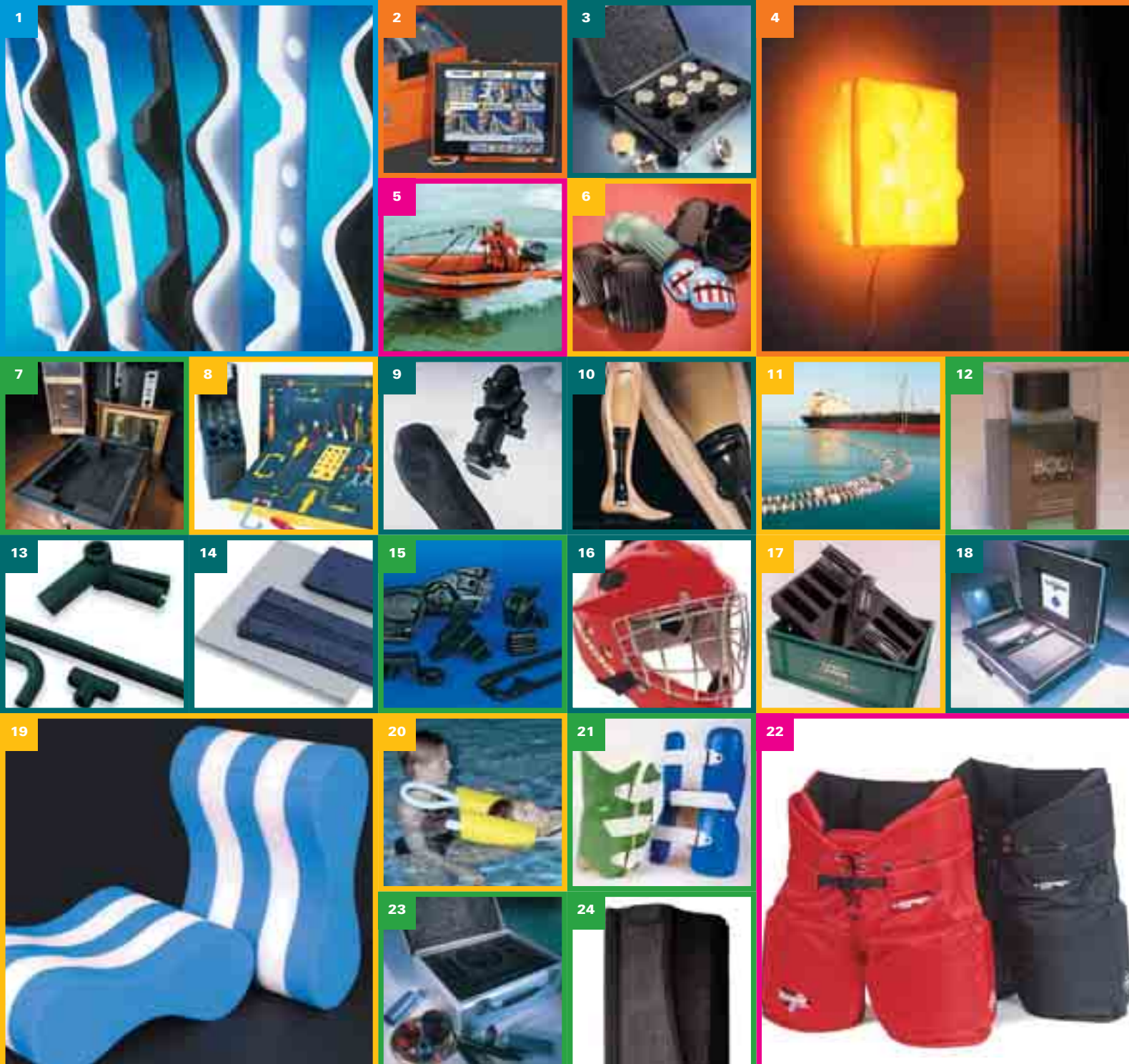




ZOTEFOAMS

Zotefoams plc Annual report and financial statements 2001



The products on this page have been produced using Zotefoams' foam. They have been grouped according to the primary quality that leads to the producers choosing Zotefoams over other materials.

- | | | | |
|--|---|--|--|
| <ul style="list-style-type: none"> 1 Eaves and ridge fillers used in the building industry 2 Packaging for in-flight medical diagnostic unit 3 Speciality packaging for sensitive electronic components 4 Atmospheric wall light cover 5 Safety buoyancy on man overboard boat 6 Knee pads for leisure and industry 7 Customised packaging for the protection of artifacts 8 Tool control case inserts 9 Wrist splint | <ul style="list-style-type: none"> 10 Moulding used to shape prosthetic legs 11 Buoyancy inter-layer for floating oil transfer hoses 12 Luxury perfume packaging 13 Lightweight flame retardant insulation in aircraft 14 Lightweight flame retardant insulation in aircraft 15 Complex moulded gaskets and noise control components for the automotive industry 16 Impact absorbing lightweight sports helmet 17 Returnable transit packaging used by automotive manufacturers | <ul style="list-style-type: none"> 18 Protective casing for portable electronic equipment 19 Swim aid 20 Buoyancy aid for children with special needs 21 Medical corset 22 Personal protective sporting equipment 23 Protective transit packaging for optical equipment 24 Speciality military packaging 25 Watersports body board 26 Packaging for electronic sensor equipment | <ul style="list-style-type: none"> 27 Professional and military camping mats 28 Expansion jointing material for civil engineering applications 29 Children's seating on supermarket trolleys 30 Lightweight aircraft seating and interiors |
|--|---|--|--|

- Purity
- Impact performance
- Durability
- Ease of processing
- Resistance to environmental exposure
- Performance to weight ratio



Zotefoams plc is the world's leading manufacturer of cross-linked block foams. Its products are used in a wide range of markets, including sports and leisure, packaging, transport, healthcare, toys, building, marine and the military.

Through a unique production process, the Company produces foams which have controllable properties and are of a strength, consistency, quality and purity superior to foams produced by other methods.

Zotefoams' strategy is to create sustained profit growth by expanding its sales internationally and by broadening its potential market with new unique products. This strategy is supported by our commitment to quality, innovation and customer service through investment in the training and development of our employees.

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Chairman's statement



2001 was a year of intensive investment activity and achievement for Zotefoams. Site restructuring and rebuilding, following the major fire at Croydon in October 2000, continued through the year and for operational reasons will not be completed until late 2002. The new manufacturing facility in Kentucky, USA became operational in July; and the first part of the Group's Enterprise Resource Planning (ERP) IT System went live in August 2001 and the remaining phases will be completed during 2002.

The quality of service to our customers improved through the year as our raw material and intermediate stock levels were re-established and site infrastructure improved. Sales growth compared with 2000 was achieved in all of our major markets. Overall sales growth of 10% was achieved despite a marked slow-down in the second half-year, particularly in our North American and Continental European markets.

Results

Profit before tax pre-exceptional items for the year ended 31 December 2001 was £2.8 million compared to £2.3 million in 2000. The 2000 figure included a one off write-off of £0.8 million on stock and capital equipment following the withdrawal from the 3D toy puzzle business and a review of development projects. Turnover increased by 10% to £23.0 million (2000: £20.8 million).

Earnings per share pre-exceptional items were 5.6p compared with 4.8p in 2000.

Costs and insurance proceeds relating to the fire at our Croydon site in October 2000 have been treated as an exceptional item. The net result is a pre-tax exceptional profit of £0.7 million. As at 31 December 2001, £6.0 million has been received from insurers and this is being re-invested in replacing assets destroyed by the fire. Discussions continue with insurers, particularly on the lost sales and additional revenue cost elements of the claim and it is anticipated that further proceeds will be received in 2002.

Profit before tax after exceptional items is £3.5 million and EPS after exceptionals is 6.9p.

Capital expenditure was £6.1 million associated mainly with fire replacement assets (£2.5 million) and completion of the US manufacturing plant (£2.8 million).

Dividend

The Directors are recommending a final dividend of 5.0p net per share. This brings the total dividend for the year to 7.5p and is unchanged from the dividend in respect of the year ended 31 December 2000.

“A year of intensive investment activity
and achievement”

Sales growth in 2001
compared to 2000 by
geographical market:

UK & Eire

5%

France

20%

Germany

12%

| | 2001 | 2000 |
|---|-------------|------|
| Turnover (£m) | 23.0 | 20.8 |
| Operating profit pre-exceptional items (£m) | 2.9 | 2.4 |
| Profit before tax (£m) | 3.5 | 2.3 |
| Earnings per ordinary share pre-exceptional items (p) | 5.6 | 4.8 |
| Earnings per ordinary share (p) | 6.9 | 4.8 |
| Net dividend per share (p) | 7.5 | 7.5 |

Board Changes

As announced in the interim report, Mike Lewsey resigned from the Board as Marketing and Sales Director in June 2001; and from July 2001, I have relinquished my executive role, but continue as part-time Chairman of the Board.

Ian Buckley has given notice of his resignation as a non-executive Director immediately after the Annual General Meeting in April 2002.

Employees

On behalf of the Board, I would like to thank all employees for their continued commitment to Zotefoams, particularly following the busiest year, in relation to internal activities, in Zotefoams' history.

Future outlook

Although complete recovery from the fire is taking longer than initially projected, all of the essential assets are now in place to move our strategic goals forward.

General economic conditions still appear fragile. Whilst we anticipate short-term growth to be driven by our manufacturing presence in North America and new marketing initiatives supported by our alliance with Sekisui, margins will be affected by increases in depreciation and insurance premiums. For the medium-term, new upgraded technical facilities are now in place and we are in a position to further our goal of developing new foamed products from high performance speciality polymers, using our unique technology.

WH Fairservice Chairman

“All of the essential assets are now in place
to move our strategic goals forward”



Managing director's review



Zotefoams has made significant progress throughout 2001. In the first full year of our alliance with Sekisui we have grown sales by 10% despite difficult market conditions throughout the second half of 2001. Our manufacturing facility in Kentucky, USA began operations in July 2001 and the major redevelopment of our Croydon site has continued following the fire there in October 2000.

During 2001 Zotefoams also implemented the first phase of a business-wide Enterprise Resource Planning (ERP) IT system and made significant progress in refocusing our business development efforts, despite the limited technical facilities available during the rebuild of our research and development laboratory.

Results

Profit after tax, excluding exceptional items, increased by 16% on sales growth of 10%. European markets, where our alliance with Alveo (the European arm of Sekisui) is particularly strong, were the fastest growing markets with a 15% sales increase over last year. However, we believe that our efforts to win sales from former Alveo customers have been badly affected by the fire in October 2000. Sales growth of 8% in North America and 5% in the UK were as a result of underlying market developments.

Zotefoams' business normally exhibits moderate seasonality with the first half buoyed by sports and leisure projects and a second half impacted by holiday periods. However, overall the second half year was weaker than we anticipated with difficult general economic conditions across all our geographic markets. The impact on demand in North America was felt early in the second half of 2001 and later, more severely, in continental Europe and the UK.

The overall balance of sales by market segments has changed little from 2000. Speciality packaging remains the largest market, accounting for around 30% of sales, with sports and leisure, industrial and construction all in excess of 10% of sales by volume. Transportation, in particular automotive and aircraft, is our fastest growing segment as pressures in these industries encourage manufacturers to look outside traditional materials for high performance solutions such as the products in the Zotefoams range.

“Profit after tax, excluding exceptional items, increased by 16%”

Production process

Stage 1:

Extrusion and cross linking of polymeric sheet



Zotefoams products have a number of key properties, which make them the preferred solution in a wide variety of end-use markets and applications.

Purity:

Our foams are made with only polyethylene (an inert polymer) and nitrogen gas (an inert gas that makes up 78% of the earth's atmosphere). To this base may be added colour or performance-enhancing additives.

Operations

I am pleased to say our facility in Walton, Kentucky has been fully operational since July 2001. Sending solid materials to the USA for expansion and onward shipping to our North American customer base gives us a unique position in this growing market. North America now accounts for 21% of our worldwide sales and we expect almost 100% of material for the North American Market to be supplied from Kentucky in 2002.

The plant also gives us a "Made in USA" tag which is particularly important in selling to key government markets, and also improves opportunities in many commercial organisations within NAFTA with whom we can now deal free of duty.

Our Croydon site has been badly impacted by site restructuring and development after the fire. As well as the insurance claim for reinstatement of buildings and plant, we have suffered significantly increased costs to maintain operations. Where these costs are clearly insurance related (e.g. hire of portacabins), we have included these within exceptional costs. Where the costs are judgemental (e.g. increased scrap rates or labour inefficiencies), we have taken a prudent approach, only classifying a proportion of these costs as exceptional.

In October 2001 BP closed the autoclave plant at its Wilton site. At that time Wilton was our largest supplier with approximately 65% of raw materials being purchased in specified grades from this site. Our policy is to have at least two sources of supply for all materials where possible and we have now moved production onto our second supplier. Significant work was required to successfully identify and specify a new alternative "second source" LDPE grade suitable for our full product range.

Rebuilding, plant expenditure and insurance

Buildings

The rebuilding programme at our Croydon site began in early 2001 and is expected to continue through to late 2002.

Areas only requiring refurbishment, such as the fabrication department, sales, engineering projects and plant

“Our facility in Walton, Kentucky
is now fully operational”



Most other cross-linked polyethylene foam manufacturing processes use hazardous chemicals as a "foaming agent", by-products of which may include ammonia and organic acids. These remain in the foam, have an unpleasant odour and are not inert.

Zotefoams materials are therefore preferred in many applications because of this purity. Applications involving

contact with skin, electronic components, fine art or explosives, are excellent examples where our performance advantage provides significant benefits.

In many health-care applications foams must be toxicologically inert. For sports goods applications, such as

management offices were occupied in late 2001. Our maintenance workshop, stores and technical laboratory, all of which required new buildings, become available in early 2002.

In all cases these departments now have new or refurbished facilities which have been equipped to modern standards.

Our site still suffers significant disruption in the finished goods, storage and despatch areas. The rebuild of these areas is particularly problematic as, in order to minimise disruption to customers, despatch operations cannot be stopped during building work. As health and safety has the highest priority the rebuilding will be completed in five separate phases to minimise risk. Each phase requires part of the site to be completely cleared for construction and only re-occupied when building work is finished. As a result we now expect completion to be in late 2002, some nine months later than originally planned.

Plant

Most of the damaged plant was in the technical department. The reinstatement of the destroyed plant with equivalent modern technology and the luxury of being able to plan from scratch allowed us to specify equipment for technical support and development of our existing products while adding the flexibility required for the analysis of a wider range of materials for future development.

In addition to this we have two other major capital programs on our Croydon site: investment in high-pressure capacity and a new extrusion line. Commissioning of these projects during 2002 will substantially complete our investment in additional capacity and, other than maintenance capital or investment to support technical developments, we do not anticipate any major new capital requirements in the near future.

“Our Croydon site still suffers significant disruption”

Production process

Stage 2:

Impregnation of polymer sheet with pure nitrogen at high temperatures and pressure



protective equipment and buoyancy aids, the foam must minimise skin irritation and sensitisation.

Impact protection

An important property of our foam is the impact protection it offers to people, packaged goods and structures. The regular

isotropic cell structure ensures maximum dissipation and absorption of energy, whatever the direction of impact. A good example of this is its use in energy-absorbing panels in the hulls of rescue boats. These are designed with soft foams to cushion impacts from either a large ship or unconscious people in the water. The foam also provides

Insurance

Other than the additional investment in high-pressure capacity all building and plant expenditure is subject to insurance claims. However the reinstatement of our despatch and storage facility involves substantial enhancement and therefore we anticipate much of this expenditure will not be covered by insurance.

Since the fire our insurance premiums have risen dramatically, from £0.1 million in 2000, to £0.2 million in 2001 and to £0.5 million in 2002 due to hardening insurance markets and reassessment of the insurance risks. Fire prevention and control systems, designed to reduce our risk and due for completion in 2002, are a significant element of the enhancement expenditure on this part of the site.

Our insurance policy has an eighteen-month indemnity period over which additional costs of working and any loss of profit can be claimed. The indemnity period ends on 21 April 2002. Currently, discussions are ongoing with insurers to quantify these additional costs and the loss of profit. No income has been recognised in the accounts for any items other than those additional costs disclosed in note 3 to these accounts. Further insurance receipts, net of associated costs, will be disclosed as an exceptional item in our 2002 Annual Report.

Our financial results from 2002 will be negatively impacted by a significant increase in depreciation as the replacement cost of many assets is substantially higher than their original cost. We anticipate this additional depreciation will further increase in 2003 as a full-year's charge is taken on assets commissioned during 2002.

Development strategy

Our strategy for future development is to build on our strengths in 2 areas:

- Polyolefin foams; and
- High-pressure foaming technology

“Reinstatement of our despatch and storage facility involves substantial enhancement”



buoyancy, not afforded by hollow-hulled boats, following a major impact.

A more familiar use is in protective sporting equipment, such as hockey padding, where the foam must be flexible and also be tough and durable to withstand repeated use.

Durability

The consistent cell structure of our foam products approximates that of a theoretically ideal foam structure. The absence of impurities from the foaming process gives far fewer points of weaknesses than in other foams. These attributes result in foams with superior durability.

Polyolefin Foams

Zotefoams produces cross-linked block foams of the highest standard available anywhere. Our product advantage comes from the unique nitrogen autoclave process used to expand solid plastic slabs into foam. However product advantage must be supported by a service capability and marketing approach, ensuring delivery to customers and markets who value our product advantages.

Polyolefin Foams: Marketing Approach

Zotefoams has occupied a strong market niche for many years. Our materials enjoy significant performance advantages due to their highly regular cellular structure. Our foams therefore exhibit improved physical performance in all major attributes as well as the ease of processing which product consistency brings. The superior properties are preferred both by our customers (who typically process materials) and by end-users who appreciate the property advantages in the final product.

As the applications for polyolefin foams are so varied our approach has been to sell to our first-line customers, many of whom specialise in defined market segments, such as sports protection or packaging. The next stage in our marketing evolution has now begun: seeking collaboration with key customers in order to access specific markets and increase end-user contact.

Our alliance with Sekisui has helped to accelerate this process, working in partnership with customers to match the benefits of our materials to market requirements. We therefore create a powerful selling advantage as our product provides benefits both to our direct customer and to the end user.

The section below describes some of the key properties of our foams. In the following table these benefits are shown for both the processors, who are our primary customers and also in the final application. Specific examples of products benefiting from these properties are shown on the Inside Front Cover:

“Zotefoams produces cross-linked block foams of the highest standard available anywhere”

Production process

Stage 3:

Final expansion of impregnated solid sheet to form foam



Applications such as kneepads may appear low-tech, but require high durability to withstand repeated compressions. Similarly for tool case inserts and returnable transit packaging rough handling can result in failure from tearing.

Where durability and a long life are required our customers recognise that Zotefoams range gives superior performance.

Ease of processing

Most of our customers are sophisticated converters of foam and will design products to achieve the “in-use” performance required by the end application. How a material will process is often of prime importance, particularly while using heat and pressure techniques to form the materials into complex

| Key Property | Benefit to processor | Benefit in final product | Key |
|--------------------------------------|----------------------|--------------------------|-----------------------|
| Purity | ● | ● | ● Significant benefit |
| Impact performance | ○ | ● | ● Major benefit |
| Durability | ● | ● | ○ Minor benefit |
| Ease of processing | ● | ○ | |
| Resistance to environmental exposure | ● | ● | |
| Performance to weight ratio | ○ | ● | |

Polyolefin Foams: Service Capability

Zotefoams ability to service our customers' needs was severely damaged by the fire in October 2000. During 2001 progress has been made in restoring inventory levels and site reinstatement, although the slow planning approval process significantly delayed the start of rebuilding our despatch facilities. Our plans are to build a covered warehouse giving substantial benefits in our service capability through improved material handling and storage.

Alongside this rebuilding program we are running two other investment programs to enhance customer service.

1. Investment in a company-wide ERP computer system. The first part of this system went "live" in August 2001 and work is on-going to enhance customer service through improved planning and scheduling and web-based information availability. Implementation of further modules improving the information available from this system will continue through 2002.
2. High-pressure capacity. Q3 2002 will see the completion of a two year programme to commission additional capacity in the key process of our business. This investment will significantly increase operational flexibility across our whole product range with corresponding improvement in service capability.

“Our philosophy is to concentrate resources where the differential advantage of our process is greatest”



shapes with high tolerances. These parts must then retain the physical properties of the foam, in many cases with very thin wall sections. Good examples of this are found in the automotive and aerospace industries that typically have tight tolerances for sealing and gasket applications.

The regularity of our cell-structure and lack of impurities are the key attributes allowing high tolerance thermoforming.

Resistance to environmental exposure

Polyethylene is inherently stable in many chemically aggressive environments.

High-Pressure: Foaming Technology

Our philosophy is to concentrate resources where the differential advantage of our process is greatest and the benefit to our shareholders is greatest. The technology we possess is currently used to foam materials such as low-density polyethylene. However we are confident that a wide range of other materials can be foamed using this process and are seeking to identify markets in higher value-added materials as a key part of our development programme.

To this end, Zotefoams has put in place a new business development structure. During 2001 Zotefoams recruited Phil Maddox as Head of European Sales & Marketing and Dr Robert Keller as President of Zotefoams Inc, both of whom have strong technical backgrounds and bring a wealth of experience in performance materials outside polyolefin foams. Together with Dr Neil Witten, who has been with Zotefoams since 1996 and leads our Technical Department, we now have the skill base in executive management to support this development strategy.

Expenditure on technical research and development increased by over 17% and is now at the highest level since Zotefoams' flotation in 1995.

We have also increased our technical contact with advanced materials suppliers to further our goal of developing unique new products in high-performance, foamed materials. These developments aim to leverage our proprietary technology to produce materials with superior performance characteristics required by existing customers, and also by potential new customers.

During the year technical development has been limited by the continuing rebuilding work underway to replace those areas severely damaged by the fire in late 2000. This limitation has not stopped the early feasibility work and future strategy development as described in the previous Annual Report.

In 2001 we clearly identified the route map for future technical and new product development. This has involved the deployment and focussing of key resources into the areas of business development through meeting the customers' technical needs and New Product Development.

“Expenditure on technical research and development is now at the highest level since flotation in 1995”



When used outdoors, our foam must withstand the climatic extremes around the world. Rain, snow and sunshine all attack the foam. In addition, for some applications such as expansion joints in bridges or tunnels the foam must additionally resist destructive substances such as fuels and cleaning chemicals. Any impurities in the polymer, such as

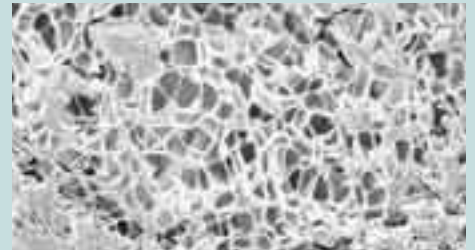
residues from a chemical foaming process, weaken its resistance to such chemicals.

Performance to weight ratio

A good performance to weight ratio requires a structure in which all of the material contributes to the required property.

As a result 2001 is considered a watershed in technical terms and in the year we have been able to:

- raise our profile and engage constructively with key suppliers of speciality resins;
- evaluate at a basic level the foaming of several materials of known market interest;
- invest some £2m in the reinstatement of our laboratory facilities; and
- specify and test laboratory equipment to offer maximum possible flexibility and technical capabilities for the future.



The micrograph above shows the structure of a high temperature, engineering resin, foamed using only existing equipment during the course of 2001.

Engaging with key speciality materials companies has led to a diverse range of product development opportunities being identified and evaluated both commercially and technically. Materials presently considered 'not foamable' have shown feasibility in our autoclave process. These exciting materials developments will be pursued during the course of 2002 controlled by our "pipeline process" for development, test marketing and manufacture.

Taking these developments forward will be a key priority in 2002 as we move towards our goal of fully exploiting our unique process.

DB Stirling Managing director

“A diverse range of product development opportunities is being identified and evaluated”



Zotefoams products have no residues and a regular cell-structure, therefore the performance of the foam is maximised per unit weight. Other foaming processes leave chemical blowing agent residues and have an irregular cell structure, both of which reduce performance by adding weight with non-contributing materials

Lightweight foams are enabling our customers to reduce component weight in transportation applications, which helps reduce the fuel consumption and costs. This weight reduction is achieved without compromising performance and is of particular interest to the aerospace industries.

Finance director's review



Turnover increased by 10% from £20.8 million in 2000 to £23.0 million in 2001. Most of this growth occurred in the first half of 2001, when the sales increase was 17%, with underlying sales growth supplemented by some customer re-stocking following the fire at Zotefoams' Croydon site in October 2000. In the second half sales growth fell to 3% in difficult economic conditions against a second half of 2000 that was affected by the fire.

Despite the sales growth, gross profit pre-exceptional items only increased marginally from £6.6 million in 2000 to £6.7 million in 2001. In percentage terms, the gross profit rate fell from 32% to 29%. North American manufacturing costs of £1.0 million and higher commission payments due to Sekisui more than offset the benefits in 2001 of improved raw material prices and the non-recurring asset write down of £0.8 million made in 2000. None of the start-up costs on the new North American manufacturing plant were capitalised. The average LDPE price, our major raw material, fell from £590 per tonne in 2000 to £538 per tonne in 2001.

Savings were made in distribution and administration costs so that profit before tax pre-exceptional items increased by 20% in 2001 to £2.8 million compared to £2.3 million in 2000. Earnings per share pre-exceptional items increased by 17% to 5.6p.

Exceptional item

A major insurance claim is being made as a result of the fire at the Croydon facility in October 2000. At the end of 2000 the costs incurred in that year, together with the net book value of the fixed assets and stock damaged or destroyed less the insurance proceeds received in 2000 were combined to form an insurance receivable balance of £0.9 million in other debtors.

For 2001 both expenditure and cash receipts from insurers have increased significantly and the fire related items have therefore been treated as an exceptional item in order to give greater transparency. Total proceeds received from the date of the fire to 31 December 2001 of £6.0 million exceeds revenue costs of £3.2 million, and the net book value of stock (£1.2 million) and fixed assets (£0.9 million) destroyed in the fire to give an exceptional gain of £0.7 million pre-tax. This gain arises as the fixed assets were insured on a replacement basis (i.e. a 'new for old' type policy) so that the amounts needed to rebuild these assets exceeds their net book value. In cash terms the Group has incurred revenue costs of £3.2 million, lost stock of £1.2 million and spent £2.5 million on replacement fixed assets giving a total cash cost of £6.9 million against proceeds received of £6.0 million at 31 December 2001.

Taxation

The effective tax rate for the Group was 27%. Corporation tax has been provided at a rate of 30%. However, there was a tax credit of £0.1 million due to the benefit of capital allowances on the investment in North America. This benefit will reduce in future years increasing the effective tax rate for the Group to 30%. Tax on the exceptional item has been provided for at 30%. At the year end there is a corporation tax debtor of £0.4 million as a result of the cash benefit of accelerated capital allowances on research and development equipment and deferral of the capital gain on the buildings destroyed in the fire.

Cash flow and Funding

EBITDA before exceptional items was £5.4million, the same level as 2000. There were working capital increases in stock of £1.4 million and trade debtors of £0.7 million. The increase in debtors is due to higher sales while the increase in stock reflects the start of the US manufacturing operation and the low stock levels in the UK last year following the fire, when over 50% of the stock at the Croydon site was destroyed. Capital expenditure of £6.1 million included £2.5 million on fire replacement assets and £2.8 million on the US manufacturing plant. Together with an unchanged dividend this resulted in a cash outflow of £4.7 million increasing net debt to £5.1 million. The balance sheet remains strong with net assets of £28.3 million giving a gearing ratio of 18%.

Treasury and Accounting Policies

| | 2001 | | 2000 | |
|-----------|---------|----------|---------|----------|
| | Average | Year end | Average | Year end |
| US Dollar | 1.45 | 1.44 | 1.51 | 1.49 |
| Euro | 1.60 | 1.60 | 1.64 | 1.64 |

Exchange rates did not have a significant impact on the 2001 results, partly due to the low foreign exchange volatility in the year but also as a result of the new manufacturing presence in North America that reduced the US dollar exposure.

Analysis of exposure to main currency groups

£million equivalent

| £m incurred in: | £ | US\$ | Euro | Total |
|---|--------|-------|-------|--------|
| Turnover | 8.5 | 4.7 | 9.8 | 23.0 |
| Cost of sales | (11.9) | (1.0) | (3.4) | (16.3) |
| Gross profit | (3.4) | 3.7 | 6.4 | 6.7 |
| Distribution costs | (0.9) | (1.1) | — | (2.0) |
| Administration expenses | (1.8) | — | — | (1.8) |
| Operating profit/(loss) pre-exceptionals | (6.1) | 2.6 | 6.4 | 2.9 |
| 2000 Operating profit/(loss) comparatives | (7.3) | 3.5 | 6.2 | 2.4 |

The construction of the new US plant has been partly funded by a \$4.2 million three year loan which is repayable in equal six monthly instalments. This partially matches our US fixed assets of \$12.4 million and will be repaid from the dollar income stream that these assets will generate.

The Board has defined policies and procedures relating to treasury management and accounting practices. These are designed to provide appropriate business support, consistency of reporting and to mitigate financial risk.

The Group policy remains to hedge foreign currency sales invoices net of foreign currency expenditure. Translation exposure is not hedged. Interest rates on borrowings are all based on variable rates plus a bank margin and are unhedged as the interest rate risk is not, at present, considered material.

Going concern statement

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.

CG Hurst Finance director

Directors and advisers



| | | | |
|---|---|---|---|
| 1 | 2 | 3 | 4 |
| 5 | 6 | 7 | |

1. Bill Fairservice PhD BSc#
Non-executive Chairman

2. Ian Buckley BSc FCA*†#
Non-executive Director,
Chairman of the Audit Committee

3. Anthony Eldrett MBA
Operations and Projects Director

4. Clifford Hurst BA FCA MCT
Finance Director and Company Secretary

5. John Marley*†#
Deputy Chairman and Senior non-executive
Director, Chairman of the Remuneration
and Nominations Committees

6. Chris Ryan BSc FiChemE CEng*†#
Non-executive Director

7. David Stirling BSc CA MBA MSc
Managing Director

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Bill Fairservice PhD BSc#**Non-executive Chairman, age 61**

Led the MBO of Zotefoams from BP Chemicals in 1992, when he became Managing Director of Zotefoams Limited and later Zotefoams plc. Appointed Chairman in January 1999. Relinquished his executive role and became part-time Chairman in July 2001. Previously spent most of his working career with BP Chemicals in a number of technical, production and business management roles.

Ian Buckley BSc FCA*†#**Non-executive Director,
Chairman of the Audit Committee, age 51**

Appointed to the Board in January 1995. Chief Executive of Tenon Group plc and previously Chief Executive of EFG Private Bank Limited and Smith & Williamson. Appointed a non-executive Director of Rathbone Brothers plc in December 2001 and subsequently announced his intention to resign from the Board of Zotefoams plc after the AGM in April 2002.

Anthony Eldrett MBA**Operations and Projects Director, age 57**

A Director since the MBO in September 1992. Previously employed by BP Chemicals for more than 25 years, holding wide-ranging positions in human resources, health and safety, engineering projects and operations management.

Clifford Hurst BA FCA MCT**Finance Director and Company Secretary, age 39**

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

John Marley*†#**Deputy Chairman and Senior non-executive Director, Chairman of the Remuneration and Nominations Committees, age 67**

Appointed to the Board in 1995. Formerly Chairman and Chief Executive of Avdel plc where he spent most of his working career developing worldwide manufacturing and marketing facilities for precision engineered products.

Chris Ryan BSc FiChemE CEng*†#**Non-executive Director, age 55**

Appointed to the Board in December 1999, Formerly Managing Director of Air Products PLC and Senior Vice President of Air Products and Chemicals Inc with responsibility for Air Products European Gases businesses. He is a graduate of the Harvard Business School ISMP Program and was previously based in the USA for five years, with global accountability for Air Products' Electronics Business, as well as Corporate Planning and Strategy.

David Stirling BSc CA MBA MSc**Managing Director, age 35**

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

*Member of the Remuneration Committee

†Member of the Audit Committee

#Member of the Nominations Committee

Stockbrokers**ING Barings**

60 London Wall
London EC2M 5TQ

Solicitors**Garretts**

2 Arundel Street
London WC2R 3GA

Registrars**Computershare Investor Services PLC**

PO Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH
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Director's Report

The Directors present their annual report and audited financial statements for the year ended 31 December 2001.

Principal activity

The Group's principal activity is the manufacture and distribution of cross-linked block foams. A review of activities during the financial year and future developments is presented on pages 2 to 13 of the annual report.

Results and dividends

Profit attributable to shareholders for the year amounted to £2.5 million (2000: £1.8 million). An interim dividend of 2.5p (2000: 2.5p) net per share was paid on 20 September 2001. The Directors recommend that a final dividend of 5.0p (2000: 5.0p) net per share be paid on 17 May 2002 to shareholders who are on the Company's register at the close of business on 19 April 2002.

Directors

All the current Directors named on page 14 served throughout the year. Mr M P Lewsey resigned from the Board on 15 June 2001.

In July 2001, Dr W H Fairservice relinquished his executive role but continues as part-time Chairman of the Board.

In December 2001, Mr Buckley announced his intention to resign from the Board of Zotefoams plc following the Annual General Meeting in April 2002.

The Directors retiring by rotation at the Annual General Meeting are Dr W H Fairservice and Mr J C Marley who, being eligible, offer themselves for re-election. Executive Directors retiring by rotation have service contracts which are determinable on 12 months written notice.

Employees

To ensure employee welfare, the Company has documented and well-publicised policies on occupational health and safety, the environment and training. It operates an equal opportunities, single status employment policy, together with an open management style. A culture of "continuous improvement" operates in all areas of the Company operations. The Company operates to a number of recognised industry standards including Quality (ISO 9002), Environmental (ISO 14001), Training (IIP) and Occupational Health and Safety (OHSAS 18001) approvals.

Substantial shareholdings

As at 8 March 2002 the Company had received notice of the following material interests of 3% or more in the issued ordinary share capital in addition to those of the Directors which are shown in the Report of the Board on Directors' remuneration.

| | Ordinary share of 5p | Percentage of issued share capital |
|----------------------------------|-------------------------|--|
| Gartmore | 4,138,828 | 11.42% |
| Edinburgh Fund Managers Group | 3,668,100 | 10.12% |
| Advanced Value Realisation Group | 2,847,200 | 7.85% |
| Acorn Income Fund Limited | 2,711,960 | 7.48% |
| Phillips and Drew Life Limited | 2,523,700 | 6.96% |
| 3i Group plc | 2,154,192 | 5.94% |
| Prudential Corporation plc | 1,718,080 | 4.74% |
| H T Troplast AG | 1,429,992 | 3.94% |

Research and development

The amount spent by the Group on R&D in the year was £622,000 (2000: £529,000).

Creditor payment policy

It is not Company policy to follow any standard or code of payment practice. Payment terms are agreed with suppliers when negotiating contracts or transactions. The Company ensures that, subject to any necessary variations which may result from supplier-related problems, the agreed payment terms are adhered to.

At 31 December 2001 trade creditors of the Company represented 44 days of purchases (2000: 47 days).

Share capital and reserves

There were no changes to the issued share capital during the year. Movements in reserves are shown in note 19 to the financial statements.

Pension scheme

The trustees of the Zotefoams' Pension Scheme comprise three employers and two employee representatives, the latter being elected by the members of the scheme. The Zotefoams' Pension Scheme is a defined benefit scheme. In October 2001 the Company closed the Zotefoams' Pension Scheme to new members and opened a new scheme, the Zotefoams' Stakeholder Pension Scheme, for new employees.

Charitable and political donations

The Group did not make any political or charitable contributions during the year.

Auditors

A resolution to re-appoint KPMG Audit Plc as the Company's auditors will be proposed at the Annual General Meeting.

By order of the Board

C G Hurst Secretary
11 March 2002

Report of the board of directors on directors' remuneration

Remuneration committee membership and terms of reference

The three independent non-executive Directors comprise the Committee which is chaired by Mr J C Marley, the Deputy Chairman.

The remuneration and emoluments of executive Directors are determined by the Remuneration Committee.

Remuneration policy

It is the aim of the Committee to reward Directors competitively whilst being sensitive to pay and employment conditions elsewhere in the Company.

The Remuneration Committee has taken into consideration that two Directors hold a material interest in the Company's shares, having participated in the management buy out in 1992. The Committee considers that the interests of these Directors are completely aligned with those of other shareholders. To recruit, retain and motivate key employees who did not participate in the management buyout, the Board decided to introduce an unapproved discretionary share option scheme. This was approved by shareholders at the Annual General Meeting in April 2001.

This scheme is operated by the Company's Remuneration Committee who decide which individuals should participate and the extent of their participation. Options granted under the scheme are normally exercisable no earlier than three years from the date of grant and no later than ten years from the date of grant.

These options only become exercisable if certain performance criteria are attained under a scaled vesting schedule. The Board believes that the performance conditions are stretching.

The performance condition that the Remuneration Committee imposed in 2001 is that an option may only be exercised, if over a period of not less than three financial years commencing at the start of the financial year in which the grant is made, the percentage growth in normalised earnings per share of the Company exceeds the percentage growth in the retail price index by over 20%.

If, in the future, other performance conditions prove to be more appropriate, these may be imposed instead, provided they satisfy the guidelines of the institutional investors.

This scheme incorporates a clause so that it is agreed with the individual, before they are granted an option, that the Company will either transfer its NICs liability to the individual, or it will recover any NICs paid in this regard upon the exercise of an option from the individual.

Bonus schemes and benefits in kind

For 2001 the Board of Directors accepted the recommendation of the Remuneration Committee to amend the bonus scheme available to executive Directors in line with provision B.1.4 of the Combined Code. Henceforth the Remuneration Committee recommended that the executive Directors should be eligible for a discretionary bonus based on performance thresholds which were set by the Remuneration Committee. These thresholds were not met and there was no payout under this scheme.

In addition executive Directors are eligible for a performance related payment under the Company's Inland Revenue approved Profit Sharing Share Scheme which is open to UK based employees. This scheme came into effect on 1 January 1997 and replaced an Inland Revenue approved Profit Related Pay Scheme. The benefit attributable to participants each year is based on adjusting a pool of value in relation to the change in profit. For 2001 there was no pay out under this scheme.

The principal benefits in kind provided to Directors include a company car, or as an alternative a non-pensionable company car cash allowance and private healthcare insurance.

Service contracts

The executive Directors and W H Fairservice have service contracts with the Company which are determinable on 12 months written notice from the Company or the respective Director.

The other non-executive Directors have an initial appointment of three years unless determined by the Director or the Company on at least six months written notice.

The remuneration of non-executive Directors is determined by the full Board after taking appropriate advice from the Company's advisers.

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

Pension scheme

The UK-based executive Directors are members of the Zotefoams' Pension Scheme which is open to all eligible employees. This entitles each of them to a pension at the date of normal retirement, based on final basic salary. Each member contributed 5% of pensionable pay to the scheme in addition to the Company's contribution rate of 12%.

The normal retirement age for executive Directors is 65. With the exception of W H Fairservice the non-executive Directors do not participate in the Zotefoams Pension Scheme.

Directors' pension entitlements

| | Age at year end | Increase in accrued pension during the year ⁽¹⁾ £ | Directors' contributions in the year ⁽²⁾ £ | Accumulated total accrued pension at year end ⁽³⁾ £ | Accumulated total at 2000 year end £ |
|-----------------|--------------------|--|--|--|---|
| W H Fairservice | 61 | 1,665 | 4,541 | 14,057 | 11,997 |
| D B Stirling | 35 | 2,768 | 4,541 | 6,891 | 3,992 |
| A Eldrett | 57 | 1,013 | 4,023 | 44,421 | 42,021 |
| C G Hurst | 39 | — | 3,691 | — | — |
| M P Lewsey | 51 | 307 | 3,496 | 29,509 | 28,269 |

- 1) The increase in accrued pension during the year excludes any increase for inflation.
- 2) These are the contributions paid or payable in the year by the Director under the terms of the scheme.
- 3) The pension entitlement shown is that which would be paid annually on retirement, based on service to the end of the year and excluding any increase for inflation.
- 4) Members of the scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.
- 5) C G Hurst joined the scheme on 2 October 2000. A zero pension is disclosed for Directors who have not completed two years' service and whose benefits have not yet vested.
- 6) M P Lewsey resigned from the Board on 15 June 2001 but remained as a part-time employee from that date.

The following is additional information relating to Directors' pensions:

- a) Normal retirement age: 65
- b) Dependents' pensions: a spouse's pension is payable on death in service of one-third of the member's annual salary at death. On death after leaving service, before retirement, a spouse's pension is payable of 50% of the member's preserved pension at leaving, re-valued from leaving to death in line with statutory revaluation increases. On death in retirement, a spouse's pension is payable of 50% of the member's pension at death, without reduction for any part of the member's pension surrendered for cash at retirement.
- c) Pension increases: guaranteed minimum pensions increase at the statutory rates. Other pensions increase by the lesser of 5% per annum or the increase in the Retail Prices Index.

Report of the board of directors on directors' remuneration

Directors' emoluments

| Remuneration in £ | Basic salary /fees | Profit share scheme | Car allowance | Other benefits | Total 2001 | Comparable 2000 |
|-------------------|--------------------|---------------------|---------------|----------------|-------------------|-----------------|
| W H Fairservice | 70,720 | — | — | 1,421 | 72,141 | 92,876 |
| D B Stirling | 108,377 | — | 10,392 | 830 | 119,599 | 103,989 |
| A Eldrett | 86,090 | — | 9,429 | 1,228 | 96,747 | 91,996 |
| C G Hurst | 78,996 | — | 9,429 | 931 | 89,356 | 21,050 |
| M P Lewsey | 46,665 | — | — | 10,126 | 56,791 | 81,146 |
| I M Buckley | 18,725 | — | — | — | 18,725 | 18,375 |
| J C Marley | 21,000 | — | — | — | 21,000 | 20,000 |
| C J Ryan | 18,725 | — | — | — | 18,725 | 18,450 |

Note:

- 1) Fees, car allowance and other benefits are non-pensionable.
- 2) Only M P Lewsey is entitled to use of a fully expensed company-owned vehicle. All other executive Directors are entitled to a company car cash allowance as determined by the Remuneration Committee.
- 3) Other benefits: Other benefits are calculated in terms of taxable values in the UK.
- 4) In July 2001 W H Fairservice relinquished his executive role and became part-time Chairman.
- 5) C G Hurst joined the Company and the Board in October 2000.
- 6) M P Lewsey resigned from the Board on 15 June 2001. From that date he was paid £13,089 as a part-time employee of the Company.

Directors' shareholdings

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

| Number of ordinary 5p shares at: | 31 December 2001 | 31 December 2000 |
|----------------------------------|-------------------------|------------------|
| W H Fairservice | 1,092,392 | 1,108,392 |
| D B Stirling | 28,625 | 20,510 |
| A Eldrett | 978,358 | 993,358 |
| C G Hurst | 8,553 | — |
| I M Buckley | 20,000 | 20,000 |
| J C Marley | 40,208 | 40,208 |
| C J Ryan | 20,000 | — |

There have been no changes to Directors' interests between the end of the financial year and the date of this report. Only one Director, W H Fairservice (3%), had shareholdings in excess of 3% as at 31 December 2001.

Share options

Options over ordinary shares granted:

| Date from | As at 31 December 2000 | Granted | Lapsed | As at 31 December 2001 | Exercise price | Exercisable | Expiry date |
|-----------------|------------------------------|---------|--------|------------------------------|-------------------|-------------|-------------|
| W H Fairservice | 10,582 | — | 10,582 | — | 163p | 1.8.2000 | 31.1.2001 |
| M P Lewsey | 10,582 | — | 10,582 | — | 163p | 1.8.2000 | 31.1.2001 |
| A Eldrett | 9,027 | — | 9,027 | — | 108p | 1.10.2001 | 1.4.2002 |
| D B Stirling | 9,027 | — | — | 9,027 | 108p | 1.10.2001 | 1.4.2002 |
| D B Stirling* | 32,085 | — | — | 32,085 | 93.5p | 23.2.2002 | 22.2.2009 |
| C G Hurst* | — | 32,432 | — | 32,432 | 92.5p | 4.4.2004 | 3.4.2011 |
| C G Hurst** | — | 125,133 | — | 125,133 | 93.5p | 24.4.2004 | 23.4.2011 |
| D B Stirling** | — | 176,470 | — | 176,470 | 93.5p | 24.4.2004 | 23.4.2011 |

UK resident Directors and UK-based employees of the Company with a contractual working week of at least 20 hours and at least one year's service are eligible to participate in Zotefoams' Savings Related Share Option Scheme. Directors' interests are set out above.

The options indicated by '*' of 32,085 shares for D B Stirling and 32,432 shares for C G Hurst have been granted under an Inland Revenue Approved Share Option Scheme. These options are not exercisable unless the Group's earnings per share, before exceptional items, increases over a three year period by at least 6% in excess of the increase in the Retail Price Index over the same period.

The options indicated by '**' of 176,470 shares for D B Stirling and 125,133 for C G Hurst have been granted under the Zotefoams Executive Share Option Scheme. These options are not exercisable unless the Group earnings per share, before exceptional items, increase by at least 20% in excess of the increase in the Retail Price Index over the three year period to 31 December 2003.

Further conditions control the amount of shares available under those options. For the full amount of shares to be available under the award the earnings per share increase over the Retail Price Index must be 40%. If the earnings per share increase over the Retail Price Index is between 30% and 40% the amount of shares available under the option is reduced by one third. If the earnings per share increase over the Retail Price Index is between 20% and 30% the amount of shares available under the option is reduced by two thirds.

There have been no changes in options granted between the end of the year and the date of this report.

No options have been granted under the Zotefoams' Employee Share Option Scheme. The middle market quoted share price at 31 December 2001 was 95p and the high and low prices during the year were 124p and 78p respectively.

By order of the Board

J C Marley Non-Executive Director and Chairman of the Remuneration Committee
11 March 2002

Corporate governance

The Directors are fully aware of the provisions contained in the Combined Code: Principles of Good Governance and Code of Best Practice. The principles set out in Section 1 of the Combined Code have been applied consistently throughout 2001 as follows.

Board composition and responsibility

At the beginning of 2001 the Board structure composed five executive Directors and three independent, non-executive Directors. W H Fairservice relinquished his executive role and became part-time Chairman in July 2001. J C Marley is the senior independent Director.

There were no changes in the non-executive Directors during the course of the year. However, I M Buckley has announced his intention to resign from the Board after the Annual General Meeting in April 2002.

Membership of various Board committees is disclosed in the Directors and advisers section of the annual report.

Appointments to the Board are proposed by a Nominations Committee and approved by majority vote of the full Board.

Re-election is required at the first Annual General Meeting following appointment and at least every three years thereafter.

Normally there are seven Board meetings scheduled each year. In 2001 nine Board meetings were held, and attendance by the Directors at these meetings was over 95%. A formal schedule of matters which require Board approval is in place. Each month all Directors receive management reports and briefing papers in relation to Board matters.

All the Directors have access to the Company Secretary and independent professional advice at the Company's expense if required for the furtherance of their duties. Training is provided for all new Directors and is available subsequently in order to fulfil the requirements of being a Director of a listed plc.

Directors' remuneration

The principles and details of remuneration policy for Directors are set out in the Report of the Board on Directors' remuneration.

Relations with shareholders

Meetings with institutional shareholders are held twice a year following announcement of the Group's interim and final results. Other meetings may be held at institutional shareholder request.

The Board considers the annual report and financial statements and Annual General Meeting to be the primary vehicles for communication with private investors. Our corporate website www.zotefoams.com contains information on the Company.

Accountability and audit

The Audit Committee, chaired by I M Buckley, meets at least twice a year. The Committee has written terms of reference which comply with the Combined Code. It assists the Board in ensuring appropriate methods of internal financial control are adopted and that the Group's annual report and other published information comply with the relevant statutory requirements. Meetings are attended, at the invitation of the Committee, by the Managing Director, Finance Director and a representative from the Group's external auditors, KPMG Audit Plc.

Statement on compliance

The Company is required to report on compliance with the detailed requirements of the Combined Code.

In relation to all provisions of the Combined Code other than those mentioned, the Company complied throughout the period under review. Where non-compliance is reported, the reasons for non-compliance are explained.

The Board has considered the requirement for the performance-related element of remuneration to form a significant proportion of the total remuneration package of executive Directors as required under provision B.1.4. It has therefore implemented a bonus and share option scheme. The share option scheme was approved by shareholders at the Annual General Meeting in April 2001. Both schemes are described in more detail in the Report of the Board on Directors' remuneration.

Internal control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss.

The Combined Code introduced a requirement that the Directors review the effectiveness of the Group's system of internal controls. This review should cover all controls including financial, operational, environmental, health and safety, compliance and risk management.

Guidance for Directors on the Combined Code (the Turnbull guidance) became operational for the accounting period ending 31 December 2000.

The Board confirms there is an ongoing process for identifying, evaluating and managing significant risks faced by the Company, that it has been in place for the year under review and up to the date of approval of the Annual Report and Accounts, that it is regularly reviewed by the Board and accords with the guidance of the Combined Code. Priorities during the year also included establishing a risk management framework for the new North American manufacturing operation, the first phase of integrating the business systems through an ERP implementation and re-establishing operating procedures following the fire at the Group's Croydon site in October 2000. These objectives were achieved in 2001 and their effectiveness will be reviewed by the Board in 2002.

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

Control environment

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

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

Risk identification

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

Information and communication

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

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

Control procedures

The Group has implemented control procedures designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to loss of assets or fraud. Measures taken include physical controls, segregation of duties, reviews by management, and external audit to the extent necessary to arrive at their audit opinion. As executive Board members are in close proximity to Group operations, an internal audit function covering financial control is not considered necessary at this time. However an internal audit function does exist to ensure compliance with procedures for environmental, quality and health and safety procedures.

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

Monitoring and corrective action

There are clear and consistent procedures in place for monitoring the system of internal financial and non-financial controls. The Audit Committee meets at least twice a year and, within its remit, reviews the effectiveness of the Group's system of internal financial controls. The Committee receives reports from external auditors and management. Non-financial controls are reviewed regularly by Executive management who report any issues and corrective actions taken directly to the Board.

Statement of directors' responsibilities

The following statement, which should be read in conjunction with the independent auditor's report, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the auditors in relation to the financial statements.

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

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

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

Independent auditors' report to the members of Zotefoams plc

We have audited the financial statements on pages 26 to 40.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the annual report. As described on page 24 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

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

We review whether the statement on pages 22 and 23 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

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

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

Opinion

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

KPMG Audit Plc

Chartered Accountants

Registered Auditor

London

11 March 2002

Consolidated profit and loss account

for the year ended 31 December 2001

| | Note | 2001 | | | 2000 £000 |
|---|------|------------------------------------|---|-------------------------------------|--------------|
| | | Pre exceptional item £000 | Exceptional item (note 3) £000 | Post exceptional item £000 | |
| Turnover – continuing operations | 2 | 22,975 | — | 22,975 | 20,828 |
| Cost of sales | | (16,227) | (2,607) | (18,834) | (14,265) |
| Gross profit | | 6,748 | (2,607) | 4,141 | 6,563 |
| Distribution costs | | (1,984) | (135) | (2,119) | (2,037) |
| Administrative expenses | | (1,845) | (326) | (2,171) | (2,175) |
| Operating profit – continuing operations | | 2,919 | (3,068) | (149) | 2,351 |
| Profit/(loss) on disposal of fixed assets | | — | 3,760 | 3,760 | (94) |
| Profit on ordinary activities before interest and tax | | 2,919 | 692 | 3,611 | 2,257 |
| Interest receivable | 6 | 35 | — | 35 | 93 |
| Interest payable and similar charges | 7 | (184) | — | (184) | (42) |
| Profit on ordinary activities before taxation | 4 | 2,770 | 692 | 3,462 | 2,308 |
| Tax on profit on ordinary activities | 8 | (738) | (206) | (944) | (557) |
| Profit for the financial year | 10 | 2,032 | 486 | 2,518 | 1,751 |
| Equity dividends – paid | | | | (906) | (906) |
| Equity dividends – proposed | | | | (1,813) | (1,813) |
| Total dividends paid and proposed | 9 | | | (2,719) | (2,719) |
| Retained loss for the financial year | 19 | | | (201) | (968) |
| Earnings per ordinary share | 9 | 5.6p | — | 6.9p | 4.8p |
| Diluted earnings per ordinary share | 9 | 5.6p | — | 6.9p | 4.8p |

Consolidated statement of total recognised gains and losses

for the year ended 31 December 2001

| | 2001 £000 | 2000 £000 |
|--|--------------|--------------|
| Profit for the financial year | 2,518 | 1,751 |
| Currency translation differences on foreign currency net investments | 308 | 52 |
| Total recognised gains and losses relating to the year | 2,826 | 1,803 |

Consolidated balance sheet

as at 31 December 2001

| | Note | 2001 | | 2000 | |
|---|--------|----------------|----------------|---------|---------|
| | | £000 | £000 | £000 | £000 |
| Fixed assets | | | | | |
| Tangible assets | 11 | 33,920 | | 30,112 | |
| | | | 33,920 | | 30,112 |
| Current assets | | | | | |
| Stocks | 13 | 3,540 | | 2,148 | |
| Debtors | 14 | 5,843 | | 5,889 | |
| Cash at bank and in hand | | 245 | | 1,518 | |
| | | | 9,628 | 9,555 | |
| Creditors: amounts falling due within one year | 15 | (8,066) | | (7,349) | |
| Net current assets | | | 1,562 | | 2,206 |
| Total assets less current liabilities | | | 35,482 | | 32,318 |
| Creditors: amounts falling due after more than one year | 16 | | (2,229) | | (433) |
| Provisions for liabilities and charges | 17 | | (5,003) | | (3,742) |
| Net assets | | | 28,250 | | 28,143 |
| Capital and reserves | | | | | |
| Called-up share capital | 18, 19 | | 1,813 | | 1,813 |
| Share premium account | 19 | | 13,707 | | 13,707 |
| Capital redemption reserve | 19 | | 5 | | 5 |
| Profit and loss account | 19 | | 12,725 | | 12,618 |
| Total shareholders' funds – equity | 20 | | 28,250 | | 28,143 |

These financial statements were approved by the Board of Directors on 11 March 2002 and were signed on its behalf by:

W H Fairservice Chairman

C G Hurst Finance Director

Company balance sheet

as at 31 December 2001

| | Note | 2001 | | 2000 | |
|--|--------|----------------|---------------|---------|--------|
| | | £000 | £000 | £000 | £000 |
| Fixed assets | | | | | |
| Tangible assets | 11 | 25,066 | | 24,107 | |
| Investments | 12 | 10,036 | | 255 | |
| | | | 35,102 | | 24,362 |
| Current assets | | | | | |
| Stocks | 13 | 2,738 | | 1,917 | |
| Debtors | 14 | 6,261 | | 11,132 | |
| Cash at bank and in hand | | 51 | | 1,254 | |
| | | 9,050 | | 14,303 | |
| Creditors: amounts falling due within one year | 15 | (7,841) | | (6,893) | |
| Net current assets | | | 1,209 | | 7,410 |
| Total assets less current liabilities | | | 36,311 | | 31,772 |
| Creditors: amounts falling due after more than one year | 16 | (2,229) | | (433) | |
| Provisions for liabilities and charges | 17 | (5,009) | | (3,759) | |
| Net assets | | | 29,073 | | 27,580 |
| Capital and reserves | | | | | |
| Called-up share capital | 18, 19 | 1,813 | | 1,813 | |
| Share premium account | 19 | 13,707 | | 13,707 | |
| Capital redemption reserve | 19 | 5 | | 5 | |
| Profit and loss account | 19 | 13,548 | | 12,055 | |
| Total shareholders' funds – equity | 20 | 29,073 | | 27,580 | |

These financial statements were approved by the Board of Directors on 11 March 2002 and were signed on its behalf by:

W H Fairservice Chairman

C G Hurst Finance Director

Consolidated cash flow statement

for the year ended 31 December 2001

| | Note | 2001 | | 2000 | |
|--|------|----------------|----------------|---------|---------|
| | | £000 | £000 | £000 | £000 |
| Net cash inflow from operating activities | 24 | | 842 | | 5,504 |
| Returns on investments and servicing of finance | | | | | |
| Interest received | | 35 | | 92 | |
| Interest paid – bank and other | | (151) | | (22) | |
| – finance leases | | (33) | | (20) | |
| | | | (149) | | 50 |
| Taxation | | | | | |
| Mainstream corporation tax | | (671) | | (963) | |
| Overseas tax | | (49) | | (22) | |
| | | | (720) | | (985) |
| Capital expenditure | | | | | |
| Purchase of fixed assets | | (6,065) | | (6,139) | |
| Sale of fixed assets | | 36 | | 982 | |
| Capital receipts from insurers relating to the fire | 24 | 4,049 | | — | |
| | | | (1,980) | | (5,157) |
| Equity dividends paid | | | (2,719) | | (2,719) |
| Cash outflow before management of liquid resources and financing | | | (4,726) | | (3,307) |
| Capital element of finance lease payments | | | (139) | | (86) |
| New borrowings | | | 2,876 | | — |
| New finance leases | | | — | | 595 |
| Management of liquid resources | | | — | | 1,600 |
| Decrease in cash in the year | | | (1,989) | | (1,198) |

Reconciliation of net cash flow to movement in net debt

for the year ended 31 December 2001

| | Note | 2001 £000 | 2000 £000 |
|--|------|----------------|--------------|
| Decrease in cash in the year | | (1,989) | (1,198) |
| Cash (inflow)/outflow from (increase)/decrease in debt and lease finance | | (2,737) | 86 |
| Decrease in liquid resources | | — | (1,600) |
| Change in net debt resulting from cash flows | | (4,726) | (2,712) |
| New finance leases | | — | (595) |
| Translation differences | | 9 | 53 |
| Movement in net debt in the year | | (4,717) | (3,254) |
| Net debt at the start of the year | | (383) | 2,871 |
| Net debt at the end of the year | 25 | (5,100) | (383) |

Notes to the financial statements

1. Accounting policies

Basis of preparation

The financial statements have been prepared in accordance with Applicable Accounting Standards, and under the historical cost accounting rules. The following principal accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements.

The Group has followed the transitional rules of FRS 17 'Retirement Benefits' this year, providing certain additional disclosures for its defined benefit pension scheme. In addition the Group has adopted FRS 18 'Accounting Policies' which did not have a material effect on the results or financial position of the Group in the current or prior year.

Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and its subsidiary undertakings. Profits arising on trading between Group undertakings are excluded. All companies within the Group make up their financial statements to the same date. Acquisition accounting has been used to produce the consolidated financial statements.

A separate profit and loss account dealing with the results of the parent company only has not been presented, as permitted by Section 230 of the Companies Act 1985.

Tangible fixed assets and depreciation

Depreciation is provided by the Group to write off the cost less the estimated residual value of tangible fixed assets by equal annual instalments over their estimated useful economic lives as follows:

| | |
|---------------------------------|--------------|
| Freehold buildings | 20 years |
| Plant and machinery | 5 – 15 years |
| Computer equipment and vehicles | 3 – 5 years |

No depreciation is provided on freehold land. Licences purchased by the Group are amortised over five years.

Assets held under finance leases are depreciated over the lease term where this is shorter than the estimated useful economic life.

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. The results of the overseas subsidiary undertakings and overseas branches are translated at the average rate of exchange ruling during the year. The assets and liabilities of the overseas undertakings are translated at the closing exchange rate. Exchange differences arising from the retranslation of the opening net investment in overseas undertakings, borrowings to hedge those net investments and differences between the profits for the year translated at the average and closing rates, are disclosed as movements on reserves.

Research and development expenditure

Expenditure on research and development is written off against profits in the year in which it is incurred.

Stocks

Stocks are stated at the lower of cost and net realisable value. In determining the cost of raw materials, consumables and goods purchased for resale, the weighted average purchase price is used. For work in progress and finished goods manufactured by the Company, cost is taken as production cost, which includes an appropriate proportion of attributable overheads.

Goodwill

Prior to 1 January 1998 goodwill relating to a business purchased was written off immediately against reserves and will be charged to the profit and loss account on any future disposal of the business to which it is related.

From 1 January 1998 the Group has adopted FRS 10 and any purchased goodwill will be capitalised and amortised to nil by equal annual instalments over its estimated useful life not exceeding 20 years.

1. Accounting policies (continued)

Pensions

The Company operates a pension scheme providing benefits based on final pensionable pay, the assets of which are held independently from those of the Company. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the Company. The Group also operates defined contribution pension schemes in the US and the UK. Contributions to these schemes are charged to the profit and loss account as they are incurred.

Finance leases

Finance leases of significant fixed assets are capitalised and depreciated in accordance with the Group's depreciation policy. The capital element of future lease payments is included under creditors. Interest is included within "interest payable and similar charges" within the profit and loss account.

Operating leases

Operating leases are any other leases which are not finance leases. Rental charges in respect of operating leases are charged to the profit and loss account on a straight line basis over the life of the lease.

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. Provision is made for deferred tax only to the extent that it is probable that an actual liability will crystallise.

Turnover

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

2. Turnover by geographical market

| | UK and Eire £000 | France £000 | Germany £000 | Other Europe £000 | North America £000 | Rest of the world £000 | Total £000 |
|------|------------------------|----------------|-----------------|-------------------------|--------------------------|------------------------------|---------------|
| 2001 | 7,791 | 2,549 | 2,984 | 4,588 | 4,725 | 338 | 22,975 |
| 2000 | 7,406 | 2,118 | 2,654 | 4,000 | 4,362 | 288 | 20,828 |

In the opinion of the Directors the Group is engaged in only one class of business. All turnover originates in the UK.

3. Exceptional item

On 22 October 2000, there was a fire at the Group's Croydon site. In last year's accounts the net expenses incurred and insurance proceeds received as a result of the fire were shown as an insurance receivable of £0.9 million in other debtors. This amount was made up of stock destroyed in the fire of £1.2 million, the net book value of fixed assets destroyed in the fire of £0.9 million, other costs incurred subsequent to the fire of £0.8 million less an interim receipt from our insurers in 2000 of £2.0 million. As the claim has progressed with substantial sums incurred and received from insurers, it is now felt more appropriate to show this as an exceptional item made up as follows:

| | 2001 £000 | 2000 £000 |
|--|--------------|--------------|
| Stock destroyed | (1,215) | — |
| Net book value of fixed assets destroyed | (941) | — |
| Revenue costs incurred | (3,201) | — |
| Cash received from insurers | 6,049 | — |
| Exceptional item before taxation | 692 | — |
| Tax on exceptional item | (206) | — |
| Exceptional item after taxation | 486 | — |

For the period from the date of the fire to 31 December 2001 cash received from insurers totalled £6,049,000. These payments have not been allocated to specific items by the loss adjustors and Zotefoams' management have therefore allocated these proceeds using their best estimates at the time of signing the accounts. The proceeds allocated by management to stock destroyed and revenue costs are £1,348,000 and the remaining proceeds have been allocated to fixed assets destroyed in the fire. In 2002 further cash receipts are expected from insurers in relation to the claim.

8. Tax on profit on ordinary activities

| | Note | 2001 | | 2000 | |
|--|------|------------|--------------|------|-------|
| | | £000 | £000 | £000 | £000 |
| UK corporation tax at 30% (2000: 30%) | | 435 | | 744 | |
| Overseas taxation | | 36 | | 35 | |
| Adjustment to prior year UK tax charge | | — | | (89) | |
| Current taxation | | | 471 | | 690 |
| Deferred taxation | | | 267 | | (133) |
| | | | 738 | | 557 |
| Tax on exceptional item: | | | | | |
| UK corporation tax | | | (788) | | — |
| Deferred tax | | | 994 | | — |
| | | | 206 | | — |
| Total tax charge | | | 944 | | 557 |

9. Dividends and earnings per share

| | 2001 £000 | 2000 £000 |
|---|--------------|--------------|
| Interim dividend of 2.5p (2000: 2.5p) net per ordinary share | 906 | 906 |
| Proposed final dividend of 5.0p (2000: 5.0p) net per ordinary share | 1,813 | 1,813 |
| | 2,719 | 2,719 |
| Dividends per ordinary share | 7.5p | 7.5p |

Earnings per ordinary share

Earnings per ordinary share is calculated by dividing profit after tax of £2,518,000 (2000: £1,751,000) by the weighted average number of shares in issue during the year. Diluted earnings per ordinary share adjusts for the potential dilutive effect of share option schemes in accordance with FRS 14.

| | 2001 | 2000 |
|--|-------------------|------------|
| Average number of ordinary shares issued | 36,255,772 | 36,255,772 |
| Deemed issued for no consideration | 9,821 | 2,071 |
| Diluted | 36,265,593 | 36,257,843 |

Shares deemed issued for no consideration have been calculated based on the potential dilutive effect of the Save As You Earn share option scheme, the Executive Share Option Scheme and options granted under the Inland Revenue Approved Share Option Scheme:

| Date from which exercisable | Exercise price £ | Average number of shares under option | |
|-----------------------------|------------------|---------------------------------------|---------|
| | | 2001 | 2000 |
| 1 October 2001 | 1.080 | 300,307 | 317,973 |
| 23 February 2002 | 0.935 | 32,085 | 32,085 |
| 4 April 2004 | 0.925 | 64,864 | — |
| 24 April 2004 | 0.935 | 301,603 | — |
| 21 August 2004 | 1.075 | 236,666 | — |

The average fair value of one ordinary share during the year was considered to be £0.9498 (2000: £0.9995).

10. Profit for the financial year

The Group accounts do not include a separate profit and loss account for Zotefoams plc (the parent undertaking) as permitted by Section 230 of the Companies Act 1985. The Parent Company profit after tax for the financial year is £4,212,000 (2000: £1,994,000).

11. Tangible fixed assets

| | Freehold land and buildings £000 | Plant and machinery £000 | Computer equipment and vehicles £000 | Total £000 |
|---|---|--------------------------------|--|---------------|
| The Group | | | | |
| Cost | | | | |
| At 1 January 2001 | 10,795 | 29,705 | 1,627 | 42,127 |
| Additions | 1,596 | 4,143 | 234 | 5,973 |
| Foreign exchange adjustments | 233 | 99 | 1 | 333 |
| Disposals | — | (215) | (30) | (245) |
| At 31 December 2001 | 12,624 | 33,732 | 1,832 | 48,188 |
| Depreciation | | | | |
| At 1 January 2001 | 1,031 | 10,229 | 755 | 12,015 |
| Charge for the year | 273 | 2,000 | 185 | 2,458 |
| On disposals | — | (176) | (29) | (205) |
| At 31 December 2001 | 1,304 | 12,053 | 911 | 14,268 |
| Net book value | | | | |
| At 31 December 2001 | 11,320 | 21,679 | 921 | 33,920 |
| Net book value of assets held under finance leases included in above | — | — | 555 | 555 |
| At 31 December 2000 | 9,764 | 19,476 | 872 | 30,112 |
| Company | | | | |
| Cost | | | | |
| At 1 January 2001 | 6,707 | 27,354 | 1,603 | 35,664 |
| Additions | 1,251 | 1,842 | 173 | 3,266 |
| Disposals | (17) | (32) | (30) | (79) |
| At 31 December 2001 | 7,941 | 29,164 | 1,746 | 38,851 |
| Depreciation | | | | |
| At 1 January 2001 | 1,031 | 9,773 | 753 | 11,557 |
| Charge for the year | 227 | 1,888 | 174 | 2,289 |
| On disposals | — | (32) | (29) | (61) |
| At 31 December 2001 | 1,258 | 11,629 | 898 | 13,785 |
| Net book value | | | | |
| At 31 December 2001 | 6,683 | 17,535 | 848 | 25,066 |
| Net book value of assets held under finance leases included in above | — | — | 555 | 555 |
| At 31 December 2000 | 5,676 | 17,581 | 850 | 24,107 |

Freehold land and buildings in the Group include £9,511,000 (2000: £7,774,000) of depreciable assets. Freehold land and buildings in the Company include £5,785,000 (2000: £4,533,000) of depreciable assets.

12. Fixed asset investments

| | Company | |
|--|---------------|--------------|
| | 2001 £000 | 2000 £000 |
| Shares in Group undertakings – at cost | 4,505 | 255 |
| Loan to Zotefoams Fabrications Limited | 5,531 | — |
| | 10,036 | 255 |

The investments consist of the entire ordinary share capital of Zotefoams International Limited (£255,000), and the entire ordinary share capital of £4,250,002 and a \$8,000,000 loan to Zotefoams Fabrications Limited. Both companies are incorporated in the UK.

The following is a complete list of the subsidiary undertakings of the company, all of which are either directly or indirectly 100% owned:

- Zotefoams International Limited
- Zotefoams Inc.
- Zotefoams Fabrications Limited

All the limited companies are incorporated in the United Kingdom, with the exception of Zotefoams Inc. which is incorporated in the USA.

The principal activities of the subsidiary undertakings are as follows: Zotefoams Fabrications Limited manufactures cross-linked block foams, Zotefoams Inc. purchases and distributes cross-linked block foams and Zotefoams International Limited is a holding company.

In the opinion of the Directors the investments in the Company's subsidiary undertakings are worth at least the amount at which they are stated in the balance sheet.

13. Stocks

| | Group | | Company | |
|-------------------------------------|--------------|--------------|--------------|--------------|
| | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 |
| Raw materials and consumables | 1,442 | 1,085 | 1,441 | 1,085 |
| Work in progress | 1,000 | 503 | 826 | 503 |
| Finished goods and goods for resale | 1,098 | 560 | 471 | 329 |
| | 3,540 | 2,148 | 2,738 | 1,917 |

Work in progress, finished goods and goods for resale include £517,743 (2000: £305,000) of overheads.

14. Debtors

| | Group | | Company | |
|--------------------------------------|--------------|--------------|--------------|--------------|
| | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 |
| Amounts falling due within one year: | | | | |
| Trade debtors | 5,154 | 4,452 | 3,932 | 3,350 |
| Amounts owed by Group undertakings | — | — | 1,685 | 6,477 |
| Other debtors | 208 | 1,394 | 187 | 1,262 |
| Corporation tax debtor | 428 | — | 428 | — |
| Prepayments and accrued income | 53 | 43 | 29 | 43 |
| | 5,843 | 5,889 | 6,261 | 11,132 |

The Group has credit insurance in place which protects approximately 92% (2000: 85%) of the Group trade debtors shown above.

Other debtors for the Group and Company in 2000 includes £0.9 million owed by insurers in respect of the fire at the Company's Croydon site on 22 October 2000. This amount was made up of stock destroyed in the fire of £1.2 million, the net book value of fixed assets destroyed in the fire of £0.9 million, other costs incurred subsequent to the fire of £0.8 million less an interim receipt from our insurers in 2000 of £2.0 million. In 2001 all revenue expenditure and cash receipts resulting from the fire has been shown as an exceptional item.

15. Creditors: amounts falling due within one year

| | Group | | | | Company | | | |
|---|-------|--------------|------|-------|---------|--------------|------|-------|
| | 2001 | | 2000 | | 2001 | | 2000 | |
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| Bank overdrafts | | 2,011 | | 1,329 | | 1,891 | | 1,275 |
| Trade creditors | | 1,195 | | 1,926 | | 1,202 | | 1,725 |
| Amounts owed to subsidiary undertakings | | — | | — | | — | | 100 |
| Other creditors including taxation and social security: | | | | | | | | |
| Mainstream corporation tax | | — | | 612 | | — | | 595 |
| Other taxation and social security | | 158 | | 133 | | 153 | | 132 |
| | | 158 | | 745 | | 153 | | 727 |
| Other creditors | | 444 | | 170 | | 368 | | 112 |
| Obligations under finance leases | | 139 | | 139 | | 139 | | 139 |
| Bank loans | | 966 | | — | | 968 | | — |
| | | 1,549 | | 309 | | 1,475 | | 251 |
| Accruals and deferred income | | 1,340 | | 1,227 | | 1,307 | | 1,002 |
| Dividends proposed | | 1,813 | | 1,813 | | 1,813 | | 1,813 |
| | | 8,066 | | 7,349 | | 7,841 | | 6,893 |

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

| | Group and Company | |
|---|-------------------|--------------|
| | 2001 £000 | 2000 £000 |
| Finance leases: | | |
| Amounts falling due in more than one year but less than two years | 139 | 139 |
| Amounts falling due in more than two years but less than five years | 155 | 294 |
| Bank loans (see note 21): | | |
| Amounts falling due in more than one year but less than two years | 966 | — |
| Amounts falling due in more than two years but less than five years | 969 | — |
| | 2,229 | 433 |

17. Provisions for liabilities and charges

| | Deferred taxation | |
|--|-------------------|-----------------|
| | Group £000 | Company £000 |
| The Group and Company | | |
| At 1 January 2001 | 3,742 | 3,759 |
| Charge for the year in the profit and loss account | 1,261 | 1,250 |
| At 31 December 2001 | 5,003 | 5,009 |

17. Provisions for liabilities and charges (continued)

Deferred tax is provided as follows:

| | Group | | Company | |
|---|--------------|--------------|--------------|--------------|
| | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 |
| Difference between accumulated depreciation and amortisation and capital allowances | 4,252 | 3,716 | 4,258 | 3,733 |
| Other timing differences | 751 | 26 | 751 | 26 |
| | 5,003 | 3,742 | 5,009 | 3,759 |

Deferred tax is provided at a rate of 30% (2000: 30%).

No amount is included above for any liability, which might arise in respect of the undistributed reserves of the Company's overseas subsidiary undertaking, which the Group does not expect to remit to the UK.

18. Share capital

| | 2001 £ | 2000 £ |
|---|-----------|-----------|
| Authorised | | |
| At 31 December | | |
| Equity: 56,000,000 ordinary shares of 5p shares | 2,800,000 | 2,800,000 |
| Allotted, called-up and fully paid | | |
| At 31 December | | |
| Equity: 36,255,772 ordinary shares of 5p shares | 1,812,789 | 1,812,789 |

Details of share options are described in note 9 to the accounts on page 33.

19. Statement of movements in reserves and share capital

| | Profit and loss £000 | Capital redemption £000 | Share capital £000 | Share premium £000 |
|----------------------------|-------------------------|----------------------------|-----------------------|-----------------------|
| The Group | | | | |
| At 1 January 2001 | 12,618 | 5 | 1,813 | 13,707 |
| Other recognised gains | 308 | — | — | — |
| Retained loss for year | (201) | — | — | — |
| At 31 December 2001 | 12,725 | 5 | 1,813 | 13,707 |
| The Company | | | | |
| At 1 January 2001 | 12,055 | 5 | 1,813 | 13,707 |
| Retained profit for year | 1,493 | — | — | — |
| At 31 December 2001 | 13,548 | 5 | 1,813 | 13,707 |

The cumulative total of goodwill written off against Group profit and loss account reserves in respect of acquisitions prior to 1 January 1998 when FRS 10 (Goodwill and Intangible Assets) was adopted amounts to:

| | £000 |
|---------|------|
| Group | 990 |
| Company | 880 |

20. Reconciliation of movements in shareholders' funds

| | Group | | Company | |
|---|----------------|--------------|----------------|--------------|
| | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 |
| Profit for the financial year | 2,518 | 1,751 | 4,212 | 1,994 |
| Dividends | (2,719) | (2,719) | (2,719) | (2,719) |
| Retained (loss)/profit for the financial year | (201) | (968) | 1,493 | (725) |
| Translation differences | 308 | 52 | — | — |
| Net addition/(reduction) to shareholders' funds | 107 | (916) | 1,493 | (725) |
| Opening shareholders' funds | 28,143 | 29,059 | 27,580 | 28,305 |
| Closing shareholders' funds | 28,250 | 28,143 | 29,073 | 27,580 |

21. Financial instruments**Policy**

The Group does not enter into significant derivative transactions. The Group's principal financial instruments comprise bank loans, cash and short-term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk and foreign exchange risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained fundamentally unchanged since the beginning of 2001.

The disclosures in this note exclude short-term debtors and creditors.

Interest rate risk

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

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

| | 2001 | | | 2000 | | |
|-----------|------------------------|---------------------------|---------------|------------------------|---------------------------|---------------|
| | Fixed rates £000 | Variable rates £000 | Total £000 | Fixed rates £000 | Variable rates £000 | Total £000 |
| Sterling | 433 | 2,011 | 2,444 | 572 | 1,275 | 1,847 |
| US dollar | — | 2,901 | 2,901 | — | 54 | 54 |
| | 433 | 4,912 | 5,345 | 572 | 1,329 | 1,901 |

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

Liquidity risk

The Group's objective is to maintain a balance of continuity of funding and flexibility through the use of overdrafts, loans and finance leases as applicable. The maturity profile of the Group's borrowings is shown in note 16 on page 36.

The Group has a short-term facility of £5.0 million which is freely transferable and convertible into sterling. This facility expires in February 2003 and is utilised by Zotefoams plc and its subsidiary undertakings under a cross-guarantee structure.

On 17 December 2001 Zotefoams plc borrowed \$4.2 million under a three year loan agreement, repayable in equal six monthly instalments. This facility is subject to covenants relating to net assets, total borrowings and cash flow.

Foreign currency risk

The Group has significant undertakings in the USA whose revenue and expenses are denominated in US dollars. In 2001 the Group borrowed \$4.2 million in US dollars to partially finance these undertakings. Zotefoams plc makes a significant proportion of its sales to European customers and these revenues are predominantly in Euro-zone currencies. It is the Group's policy to hedge the foreign currency cash flows of invoiced sales net of expected foreign expenditure. Hedging is achieved by the use of foreign currency contracts expiring in the month of expected cash flow.

Fair values

There is no material difference between the fair value and book value of the Group's financial assets and liabilities.

22. Commitments

| | 2001 £000 | 2000 £000 |
|---|--------------|--------------|
| (i) Capital contracts at the end of the financial year for which no provision has been made | 3,305 | 1,156 |
| (ii) The Group has annual commitments under non-cancellable operating leases which expire between two and five years: | | |
| Other operating leases | 301 | 248 |
| (iii) As at 31 December the Group had foreign currency forward exchange contracts amounting to: | — | 1,364 |

The above amounts apply to the Company as well as the Group apart from Capital Commitments in 2000 which included £850,000 in respect of subsidiary undertakings.

23. Pension scheme

The Company operates one main defined benefit scheme in the UK. Contributions to the Group's defined benefit pension scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the Company. A full actuarial valuation was carried out at 6 April 1999 and updated to 31 December 2001 by a qualified independent actuary. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. The major assumptions used by the actuary were as follows:

| | At year end 31 December 2001 % p.a. |
|---|--|
| Rate of general increase in salaries | 4.50 |
| Rate of increase of pensions in payment | 2.25 |
| Discount rate | 5.83 |
| Inflation assumption | 2.50 |
| Rate of increase of pensions in deferment | 2.50 |
| Equities | 7.95 |
| Bonds | 5.39 |
| Cash/other | 4.50 |

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

The fair value of the scheme's assets, which are not intended to be realised in the short-term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

| | At year end 31 December 2001 £000 |
|------------------------------|--|
| Total market value of assets | 9,776 |
| Actuarial value of liability | (9,897) |
| Deficit in the scheme | (121) |
| Related deferred tax asset | 36 |
| Net pension liability | (85) |

Following the actuarial valuation at 6 April 1999, it was agreed that the Company would pay a contribution rate of 10.6% Pensionable Salaries to 31 December 1999 and then 12.0% thereafter in addition to the employee contribution of 5%, subject to review at future valuations. The total Company contributions to the scheme paid in the year amounted to £418,741.

In addition there is a stakeholder scheme for new UK employees from 1 October 2001. There were no contributions to the scheme in the period up to 31 December 2001.

For US-based employees Zotefoams Inc. and Zotefoams Fabrications operates a 401(k) plan and a defined contribution pension plan to which Zotefoams Inc. contributes 6.2% of pensionable salary.

24. Reconciliation of operating profit to net cash inflow from operating activities

| | 2001 £000 | 2000 £000 |
|---|----------------|--------------|
| Operating (loss)/profit | (149) | 2,351 |
| Depreciation charge | 2,458 | 3,013 |
| (Increase)/decrease in stocks | (1,394) | 339 |
| Decrease/(increase) in debtors | 184 | (1,031) |
| (Decrease)/increase in creditors | (257) | 832 |
| Net cash inflow from operating activities | 842 | 5,504 |

Insurance proceeds relating to the fire for £6,049,000 have been received at 31 December 2001. £1,348,000 of this has been provisionally allocated to revenue and the remainder to capital as described in note 3 to the accounts on page 31. Of the insurance proceeds, £4,049,000 was received in 2001 and £2,000,000 in 2000. In 2000 the costs incurred relating to the fire in that year and the £2,000,000 insurance proceeds were netted together in other debtors and form part of the debtors movement in the cash flow statement. In 2001 this insurance debtor account has been released to the profit and loss account as part of the exceptional item.

25. Analysis of changes in net (debt)/funds

| | At 1 January 2001 £000 | Cashflow £000 | Translation differences £000 | At 31 December 2001 £000 |
|----------------------------------|---------------------------------|------------------|------------------------------------|-----------------------------------|
| Cash at bank and in hand | 1,518 | (1,308) | 35 | 245 |
| Bank overdrafts | (1,329) | (681) | (1) | (2,011) |
| Obligations under finance leases | (572) | 139 | — | (433) |
| Bank loans | — | (2,876) | (25) | (2,901) |
| | (383) | (4,726) | 9 | (5,100) |

Five year trading summary

| | 2001 £m | 2000 £m | 1999 £m | 1998 (restated) £m | 1997 (restated) £m |
|---|-------------|------------|------------|--------------------------|--------------------------|
| Turnover | 23.0 | 20.8 | 22.4 | 24.2 | 24.4 |
| Operating profit (excluding exceptional items) | 2.9 | 2.4 | 5.7 | 7.3 | 8.0 |
| Profit before tax (excluding exceptional items) | 2.8 | 2.3 | 5.8 | 8.0 | 8.0 |
| Profit before tax (including exceptional items) | 3.5 | 2.3 | 5.8 | 8.0 | 8.0 |
| Profit after tax | 2.5 | 1.8 | 4.1 | 5.7 | 5.7 |
| Capital expenditure | 6.1 | 6.1 | 2.7 | 4.3 | 3.3 |
| Net cash flow from operating activities | 0.8 | 5.5 | 7.7 | 9.2 | 9.5 |
| Dividends per ordinary share (p) | 7.5 | 7.5 | 7.5 | 7.2 | 6.7 |
| Earnings per share (p) | 6.9 | 4.8 | 11.2 | 15.6 | 15.7 |

Financial calendar

| | |
|--------------------------------------|---|
| Annual General Meeting | 25 April 2002 |
| Payment of final dividend | 17 May 2002 to shareholders on the register at the close of business on 19 April 2002 |
| Announcement of 2002 interim results | August 2002 |
| Payment of interim dividend | September 2002 |
| Announcement of 2002 results | March 2003 |


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