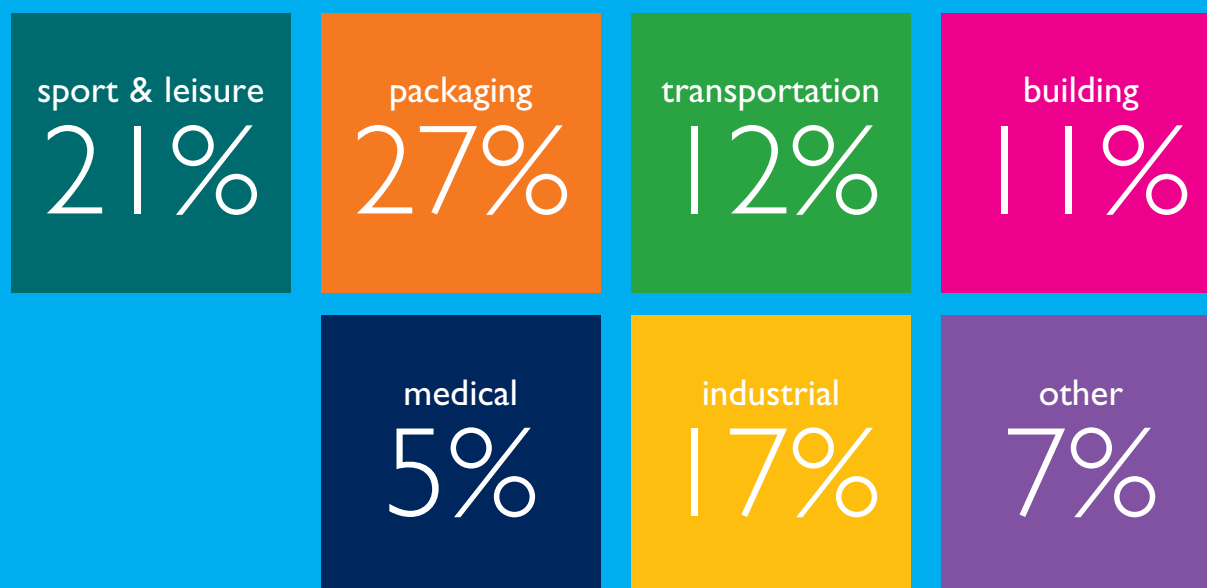


zotefoams plc annual report and financial statements '02



## BREAKDOWN OF TURNOVER BY MARKET SECTOR



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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.



We begin 2003 with a strong balance sheet, limited requirement for capital expenditure and anticipate strong cash generation throughout the year. I believe we are well placed to build our business over the longer term despite the uncertain economic outlook.

A key element of the business strategy is to grow shareholder value through increasing sales and exploiting the benefits of increased asset utilisation. Over the past year sales growth has been achieved in our major markets of Europe and North America, despite difficult market conditions with strong growth being recorded in both areas in the second half of the year. I am also pleased to report good sales growth in Asia, serviced through our alliance with Sekisui Chemical Co., albeit from a low base. However sales to the UK market declined in the year due to the lower levels of domestic manufacturing activity and this fall in our largest single market has limited overall sales growth to 2%.

During the year, recovery from the fire at our Croydon site continued and the rebuilding of our warehousing and dispatch facility in late 2002 substantially completed what has been a significant programme of enforced capital expenditure on this site. While the assets now in place are of a higher standard than before, and the limited site redesign permitted should ultimately allow some efficiencies,

the increase in depreciation from these assets has substantially reduced operating profit this year and will continue to do so into the coming year.

#### **RESULTS**

Profit before exceptional items for the year ended 31 December 2002 was £1.95 million compared to £2.77 million in 2001. Following settlement of the insurance claim relating to a fire at our Croydon site in October 2000, an exceptional profit of £6.6 million was recognised from cash receipts of £7.8 million.

Earnings per share were 16.6p (2001: 9.0p) of which 12.6p (2001: 3.4p) was attributable to exceptional profit.

Capital expenditure was £5.2 million of which £3.1 million was associated with the replacement of assets destroyed in the fire.

#### **DIVIDEND**

The Directors are recommending a final dividend of 5.0p net per share payable on 21 May 2003 to shareholders who are on the Company register

	2002	2001
Turnover (£m)	23.5	23.0
Operating profit pre-exceptional items (£m)	2.2	2.9
Profit before tax (£m)	8.6	3.5
Earnings per ordinary share pre-exceptional items (p)	4.0	5.6
Earnings per ordinary share (p)	16.6	9.0
Net dividend per share (p)	7.5	7.5

**+2%**

total sales growth from 2001 to 2002

total sales growth by geographical area

UK and Eire	-6%	Other Europe	-1%
France	+8%	North America	+13%
Germany	+5%	Rest of World	+18%

at the close of business on 22 April 2003. This brings the total dividend to 7.5p and is unchanged from the dividend in respect of the year ended 31 December 2001.

#### BOARD CHANGES

As indicated in last year's annual report Ian Buckley resigned as a non-executive Director following our Annual General Meeting in April 2002.

Roger Lawson joined the Board in December 2002 and was appointed Chairman of the Audit Committee, replacing John Marley who held the position since the resignation of Ian Buckley. Roger was a Director of 3i plc and is a former President of the Institute of Chartered Accountants in England and Wales.

#### EMPLOYEES

Zotefoams' success is dependent on the commitment, support and efforts of all its employees. On behalf of the Board I would like to extend thanks to all employees for their contribution to the business over the past year.

#### PROSPECTS

The year has started with reduced sales activity and a sharp increase in the price of LDPE, our major raw material. Despite this our expectation is for moderate sales growth in all our major markets. Good initial progress has been achieved in the development of new high performance polymer foams. However it is unlikely that this will have any significant impact on 2003 due to long approval processes. Cost pressures will continue to impact our business, with additional depreciation and increased employment costs from pensions and National Insurance.

We begin 2003 with a strong balance sheet, limited requirement for capital expenditure and anticipate strong cash generation throughout the year. I believe we are well placed to build our business over the longer term despite the uncertain economic outlook.

**W H FAIRSERVICE**  
 CHAIRMAN



Overall sales growth of 2% comprises a decline of 6% in the first half of 2002 and an increase of 12% in the second half when compared with previous year.

The increase in turnover in the second half of the year was particularly pleasing given the continued difficult market conditions prevailing through this period.

#### **RESULTS**

Profit before tax pre-exceptional items for the year ended 31 December 2002 was £1.95 million compared with £2.77 million for the same period last year. Cost increases arose principally from higher depreciation on our investment in North America and depreciation on new assets replacing those destroyed in the fire at Croydon in October 2000, and increased insurance charges. These offset an increase of 2% in turnover. The increase in turnover in the second half of the year was 12% compared to the same period last year, which was particularly pleasing given the continued difficult market conditions prevailing through this period.

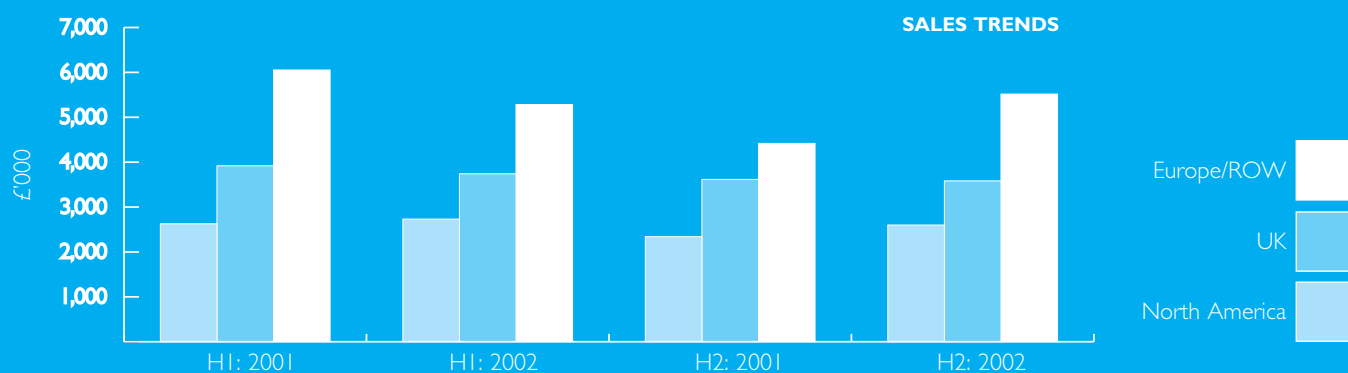
Earnings per share pre-exceptional items were 4.0p compared with 5.6p in 2001.

Settlement of our insurance claim was finalised at £13.9 million in July 2002 following the fire at our Croydon site in October 2000. Total proceeds of £6.1 million (and costs of £5.4 million) were recognised in our financial statements to 31 December 2001 with the remaining £7.8 million of proceeds and £1.2 million of revenue costs recognised during 2002.

During 2002 growth of 3% in Europe and a decline of 6% in UK reflected market conditions in these areas. Growth of 13% in North America was achieved principally through targeted market share increase in the automotive and speciality packaging segments.

Overall sales growth of 2% comprises a decline of 6% in the first half of 2002 and an increase of 12% in the second half when compared with previous year. During the first half of 2001 most of our major customers restocked following the fire in 2000 which constrained supplies in late 2000 and early in 2001. This resulted in a strong first half in all our major markets in this period. Compared to 2001, second half sales improved by 21% in North America and by 24% in Europe and Rest of the World, while the difficult UK manufacturing economy was the main reason for a 8% decline in UK sales in this period.

Over the last two years our operational cost base has increased in three major areas: the fixed costs associated with our Walton, Kentucky plant which are directly attributable to our strategy of increasing sales to the key North American



market; increased insurance premiums due to a generally “harder” insurance market and premium increase following the major fire in 2000; and increased depreciation at our Croydon site as reinstatement following the fire increases our overall asset base. Compared with 2001 the increase in depreciation is £0.6 million, and insurance premiums have increased by £0.3 million. We have reduced our insurance premiums for 2003 as Croydon site restoration and risk improvement measures are completed, however depreciation will continue to increase as the assets commissioned during 2002 are subject to a full-year depreciation charge in 2003.

Although this increased depreciation affects profitability, Zotefoams operating cashflow remains extremely strong. During the year our net cash inflow from operating activities was £11.0 million. Net insurance proceeds received in the year were £6.6 million, £5.7 million of which are included in operating cashflow and £0.9 million treated as a disposal of fixed assets. Capital expenditure of £5.2 million, mainly related to site reinstatement, which was substantially completed in October

this year with the rebuilding of our warehouse and despatch area. Before repayment of debt and equity dividends, our net cash inflow was £5.9 million.

#### MARKET OVERVIEW

Zotefoams products are used in a wide variety of applications across many market segments. This diversity reduces exposure to variations in economic activity in specific sectors, however the fragmentation of end-markets makes the focus of sales effort extremely important. Our strategy is to concentrate sales resource in a limited number of segments and applications with the largest potential for our foams to replace competitive materials – markets such as automotive and construction offer significant opportunities for business development.

Development of markets such as sports and leisure, and speciality packaging, which are more fragmented, rely on close co-operation with customers who focus on these markets.

In most markets our products have qualities which make them the preferred technical solution,

# packaging & protection

Packaging and protection, by volume our largest sales segment, utilise the benefits of impact protection, energy absorption, piece isolation and cosmetic appearance. The majority of applications in the packaging segment are for high performance, "permanent" packaging such as storage of museum artifacts, shuttle packaging common in the automotive industry, or display packaging for luxury goods. Electronic and ordnance packaging are other areas where the performance requirements due to purity, particularly an absence of corrosive and staining substances, combine with the impact protection available from all our packaging grade products.

Electronic packaging solution  
(purity, ESD protection)



Automotive 'shuttle'  
packaging (durable, re-usable)

Luxury promotional packaging  
(aesthetics, odourless)



however increasingly the service requirements of our customers are becoming a more important part of our total sales package. The combination of shorter lead-times and reduced stock-holding at customers has increased volatility of order pattern and shortened order books. This requires Zotefoams to be more flexible and respond more quickly to customer requirements while ensuring that our commitments on delivery are achieved. This must be achieved against more stringent insurance covenants restricting the volumes and conditions of inventory holding to minimise fire risk. Since the reinstatement of our warehousing and dispatch facilities at Croydon in late 2002 we have the physical assets in place to manage this situation and implementation of the advanced planning module of our ERP computer system, scheduled for mid 2003, will provide further enhancement of our service capability through better plant scheduling.

## MANUFACTURING AND CAPACITY

Zotefoams currently have a full-capability manufacturing plant in Croydon, England and

a satellite, expansion plant in Kentucky, USA. Over the past four years there has been significant investment in capital expenditure in both locations involving:

- Building and commissioning the plant in Kentucky at a cost of US\$13 million;
- Site rebuilding following the fire in October 2000, including additional extrusion capacity and a full rebuild of our technical facilities, on the Croydon site at a total cost of £6.0 million; and
- Investment in a fully integrated ERP IT system covering both sites.

Due to the complexity and dynamics of our process, increasing capacity requires a longer term view of the business. Investment decisions relating to our high-pressure equipment must be made at least two years before the capacity is required on-stream. Additional high-pressure capacity, representing an increase of approximately 20%, is expected to be installed by the end of 2003. We anticipate that there will be no requirement to increase capacity at either of our sites in the immediate future and capital expenditure will be focused on equipment

# industrial

Many industrial applications rely on the tear resistance, strength and durability of our materials, such as the Rak-gard pallet racking protectors (pictured).

The ability to work to tighter tolerances when cutting and moulding our foams is key to the performance of seals and gaskets used in a wide range of industries. Other applications include loud speaker cones, air conditioning insulation and anti-vibration pads for machinery.

Our foams are also used as an underlay in the construction of sports floors where their shock absorption characteristics can help prevent injuries.



Warehouse racking protection  
(durable, impact protection)

Sports flooring (durability)



enhancement and replacement. We therefore expect the amount of capital expenditure to reduce significantly from levels seen in the last three years.

## STRATEGY FOR THE BUSINESS

Zotefoams strategy is to concentrate resources where the differential advantage of our process is greatest and the benefit to our shareholders is greatest. While we currently enjoy substantial product advantages in cross-linked polyolefin foams, we believe that development of markets outside these areas offer excellent scope for Zotefoams. Our approach is therefore to:

- Grow the existing polyolefin business through organic market development of the North American market and through focused efforts in key application sectors across Europe and Asia; and
- Invest resource in development of new foam materials where we believe there are market requirements and where our foaming process will give demonstrable and sustainable advantage;

In North America our market development activity continues to be a balance of development

projects with existing and with new customers. The period since July 2001, when we opened our plant in Kentucky, has been an extremely difficult one for manufacturing business in North America. However we are fully committed to this market and our sales and marketing activity has continued throughout this period. As a result we have more direct customers than ever before in North America and have established our credentials in the key industries of automotive, packaging and construction which we believe offer longer term potential.

In Europe and Asia our alliance with Sekisui is key to market development. Sekisui, through their European subsidiary, Alveo, represent Zotefoams as our exclusive agent in Europe and parts of Africa and South America. Customer contact for placing of orders and initiating new projects is almost entirely handled by Alveo. Sekisui also act as distributor for Zotefoams products in Asia, where the focus is on development of applications in higher value-added areas, such as the electronics business using our conductive and static dissipative foams.

# sports & leisure

Zotefoams has been active in the sports and leisure market for over 30 years with products ranging from camping mats through to impact protection in both field and ice hockey. In this ever changing market segment the properties, such as tear resistance, impact absorption, and colour availability, make the materials first choice for a wide range of applications.



High end bodyboard  
(stiffness to weight ratio,  
ease of fabrication)



Cricket leg pads & gloves  
(repeated impact performance)

During 2002 good progress was made in early feasibility trials for a number of high-performance polymer foams. Examples of some of these materials were exhibited at trade shows and discussed with a limited number of potential customers. Initial feedback has been very positive and reinforced our belief that developments from materials such as these will be valued by the market. However we are aware that developments of this kind, which offer potentially high rewards, also carry higher levels of risk. Our approach is therefore to ensure our development activities are tightly focused and that projects which show good potential are progressed to market sampling quickly.

Expenditure on technical development will vary depending on the progress of individual projects. Although we spent less in 2002 than 2001 our intent is to gradually increase the allocation of resources to technical and business development of new products.



Cash generation remains strong with EBITDA pre-exceptional items of £5.1 million.

There is no immediate need for further capacity improvements and capital expenditure will therefore revert to maintenance levels.

Turnover increased by 2% to £23.5 million in 2002 from £23.0 million in 2001. Despite the higher sales gross profit pre-exceptional items fell from £6.7 million in 2001 to £6.2 million in 2002. In last year's annual report we indicated expected cost increases in insurance premiums and depreciation. Both these increases occurred. Insurance premiums rose from £0.2 million to £0.5 million and depreciation, following the completion of the US plant and replacement of items destroyed in the fire at Croydon, increased by £0.6 million. These were partially offset by a £0.2 million benefit in raw material costs from a reduction in the price of LDPE, our major raw material, from an average price of £538 per tonne in 2001 to £488 in 2002.

Insurance premiums for Zotefoams plc have fallen to £0.4 million for 2003 following risk improvements made to the Group's Croydon site. However, depreciation is forecast to rise again in 2003 principally because of the full year effect of assets completed in 2002.

Profit before tax pre-exceptional items was £1.95 million compared to £2.77 million in 2001. Earnings per share pre-exceptional items were 4.0p compared to 5.6p in 2001.

#### **EXCEPTIONAL ITEM**

There was a major fire in October 2000 at the Group's Croydon manufacturing facility. This was subject to an insurance claim. In total £13.9 million has been received from insurers as a full and final settlement – £6.1 million up to 31 December 2001 and £7.8 million in 2002. Revenue costs relating to the fire are £6.6 million of which £5.4 million was recorded in 2001 and £1.2 million in 2002. An exceptional profit has been made of £7.3 million in total, £0.7 million in 2001 and £6.6 million in 2002.

The exceptional profit has two main components. Part of the insurance settlement covers compensation for sales revenue lost as a result of the fire. Management estimate that the insurance proceeds relating to the lost profit on this sales revenue was £3.5 million. The settlement also covered replacement of plant and buildings destroyed by the fire. The net book value of these items was £0.9 million. However, the insurance proceeds received were based on the replacement value of these assets generating a profit which management estimates to have been £4.6 million. Capital expenditure of £6.0 million to replace these assets is higher than the

**Analysis of capital expenditure**

	2002 £m	2001 £m	2000 £m	1999 £m
Maintenance expenditure	1.9	0.8	1.6	1.9
US Plant	0.2	2.8	4.5	0.8
Fire replacement assets	3.1	2.5	—	—
Total capital expenditure	5.2	6.1	6.1	2.7

Expenditure on fire replacement assets has been largely funded by insurance proceeds. Excluding these the dividend is covered by cash flow.

**Cash flow excluding fire related items**

	2002 £m
Operating profit pre-exceptionals	2.2
Depreciation	3.1
Less depreciation on fire related assets	(0.2)
EBITDA pre-exceptionals	5.1
Working capitals movement/interest	(0.2)
Tax paid	(0.5)
Less tax payment on exceptional item	0.4
	4.8
Capital expenditure	(5.2)
Less capital expenditure on fire replacement assets	3.1
	2.7
Dividend	(2.7)
Net cash flow	—

replacement value recovered because of expenditure on risk improvements incorporated into the rebuilding programme. The major risk improvement has been to cover the finished good stock storage area with a sprinkler system.

Deducting the capital expenditure relating to the fire (£6.0 million) from the exceptional profit of £7.3 million and adjusting for the net book value of assets destroyed (£0.9 million) gives a net cash inflow of £2.2 million relating to the fire in the period 2000–2002. This falls to approximately £1.4 million after corporation tax.

**TAXATION**

The effective tax rate for the Group pre-exceptional items was 26.5%. Corporation tax has been provided for 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%.

FRS 19 "Deferred Taxation" has been adopted in 2002. Under the rules of FRS 19 a prior year adjustment has been made releasing £0.7 million

from the deferred tax provision. This release is for that element of the provision which relates to capital gains on buildings, principally those destroyed by the fire and provided for in 2001. As these gains have been rolled over into replacement assets this tax liability is not expected to crystallise in the foreseeable future and under the rules of FRS 19 has been released.

**CASHFLOW AND FUNDING**

Cash generation remains strong with EBITDA pre-exceptional items (operating profit plus depreciation) of £5.1 million, slightly down on the £5.4 million achieved in 2001 and 2000. Although capital expenditure has been high in recent years, this is because of the replacement of assets destroyed in the fire and the new US plant. With this programme nearly complete there is no immediate need for further capacity improvements and capital expenditure will therefore revert to maintenance levels.

After fire related items the net cash inflow was £3.2 million reducing net debt to £1.7 million at the end of 2002. With net assets of £31.6 million the level of gearing is low at 5%.

**Treasury and accounting policies**

	2002		2001	
	Average	Year end	Average	Year end
US Dollar/Sterling	1.51	1.60	1.45	1.44
Euro/Sterling	1.59	1.53	1.60	1.60

Exchange rates did not have a significant impact on the 2002 results. The Group's main exposure is to the euro where the average exchange rate in 2002 was almost identical to that in 2001. There was a 4% adverse movement in the average US dollar rate compared to 2001, however US dollar/sterling movements have less of an effect on the Group's operating results. The exposure of the Group to currency movements is indicated below:

**Analysis of exposure pre-exceptional items to main currency groups**

**£million equivalent**

£m incurred in:	£	US\$	Euro	Total
Turnover	7.7	5.4	10.4	23.5
Cost of sales	(12.3)	(1.9)	(3.1)	(17.3)
Gross profit	(4.6)	3.5	7.3	6.2
Distribution costs	(1.0)	(0.9)	—	(1.9)
Administration expenses	(2.1)	—	—	(2.1)
Operating profit/(loss) pre-exceptionals	(7.7)	2.6	7.3	2.2
2001 Operating profit/(loss) pre-exceptionals	(6.1)	2.6	6.4	2.9

**PENSIONS**

The Group has made the disclosures required under the transitional rules of FRS 17 "Retirement Benefits" in respect of the defined benefit pension scheme for UK employees. Under these rules the pension fund had assets of £8.2 million and liabilities of £11.5 million as at 31 December 2002. The scheme has been closed to new entrants from 1 October 2001 and following an actuarial review on 6 April 2002 Company contributions to the fund increased from 12% to 14.1% and employee contributions from 5% to 6.5% of pensionable salary effective from 1 March 2003.

**TREASURY AND ACCOUNTING POLICIES**

The construction of the US plant has been partly funded by a \$4.2 million three year loan, repayable in equal six monthly instalments. The loan is repaid from the dollar income generated by the Group's North American operations and at the end of 2002 \$2.8 million of this loan was outstanding.

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.

**C G HURST**  
 FINANCE DIRECTOR



**Bill Fairservice PhD BSc#**  
Non-executive Chairman, age 62  
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.



**Roger Lawson FCA\*†#**  
Non-executive Director and Chairman of the Audit Committee, age 57  
Appointed to the Board in December 2002. Previously a Director of 3i plc and a former President of the Institute of Chartered Accountants in England and Wales. He is a non-executive Director of King's Court Trust Corporation plc, a number of unlisted companies and a trustee of the Thalidomide Trust.



**Anthony Eldrett MBA**  
Operations and Projects Director, age 58  
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 40  
Joined Zotefoams plc in October 2000 from Thermos Limited where he was Commercial Director and prior to that Finance Director. Previously with Caradon plc (now Novar plc), ICI plc and Ernst & Young.



**John Marley**\*†#  
Deputy Chairman and Senior non-executive Director, Chairman of the Remuneration and Nominations Committees, age 68

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 56  
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 36  
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

**Registered office**  
675 Mitcham Road  
Croydon CR9 3AL  
Registered number 2714645

**Financial advisers**  
Hawkpoint Partners Limited  
4 Great St Helens  
London EC3A 6HA

**Auditors**  
KPMG Audit Plc  
1 Forest Gate  
Brighton Road  
Crawley RH11 9PT

**Bankers**  
Barclays Bank PLC  
PO Box 544  
City Service Centre  
54 Lombard Street  
London EC3V 9EX

**Solicitors**  
Lawrence Graham  
190 Strand  
London WC2R 1JN

**Collyer-Bristow**  
4 Bedford Row  
London WC1R 4DF

**Registrars**  
Computershare Investor Services PLC  
PO Box 82  
The Pavilions  
Bridgwater Road  
Bristol BS99 7NH  
[www.computershare.com](http://www.computershare.com)

The Directors present their annual report and audited financial statements for the year ended 31 December 2002.

#### **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 11 of the annual report.

#### **RESULTS AND DIVIDENDS**

Profit attributable to shareholders for the year amounted to £6.0 million (2001 restated: £3.3 million). An interim dividend of 2.5p (2001: 2.5p) net per share was paid on 19 September 2002. The Directors recommend that a final dividend of 5.0p (2001: 5.0p) net per share be paid on 21 May 2003 to shareholders who are on the Company's register at the close of business on 22 April 2003.

#### **DIRECTORS**

All the current Directors named on pages 12 to 13 served throughout the year, apart from Mr R H Lawson who was appointed to the Board in December 2002. In addition Mr I M Buckley was a Director until April 2002.

The Directors retiring by rotation at the Annual General Meeting are Mr A Eldrett and Mr C J Ryan who, being eligible, offer themselves for re-election. Mr R H Lawson, who was appointed a Director since the last Annual General Meeting, being eligible, also offers himself for reappointment at the Annual General Meeting. Mr Eldrett has a service contract which is determinable on 12 months written notice. Mr Ryan and Mr Lawson have service contracts which are determinable on 6 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 10 March 2003 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
Edinburgh Fund Managers Group	5,539,080	15.28%
Alveo AG (a subsidiary of Sekisui Chemical Co)	3,465,762	9.56%
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%
HT Troplast AG	1,429,992	3.94%

The holding held by Edinburgh Fund Managers includes beneficial and non-beneficial interests. The non-beneficial interests include holdings held on behalf of the Mineworkers Pension Scheme (1,700,440 shares, 4.69%) and British Coal Staff Superannuation Scheme (1,700,440 shares, 4.69%).

#### **RESEARCH AND DEVELOPMENT**

The amount spent by the Group on R&D in the year was £492,000 (2001: £622,000).

#### **CREDITOR PAYMENT POLICY**

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

At 31 December 2002 trade creditors of the Group represented 30 days of purchases (2001: 44 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  
10 MARCH 2003

**REPORT OF THE BOARD OF DIRECTORS' REMUNERATION****INFORMATION NOT SUBJECT TO AUDIT****REMUNERATION COMMITTEE MEMBERSHIP AND TERMS OF REFERENCE**

The 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 Board on the advice of the Remuneration Committee.

The Remuneration Committee has access to independent advice where it considers it appropriate.

**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 policy is that performance related components should form a significant portion of the overall remuneration package.

The Company operates an unapproved discretionary share option scheme for Executive Directors and senior employees. 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 2002 is that an option may only be exercised, if over a period of three 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%. A full award is only made if earnings per share exceed the percentage growth of the retail price index by 40%.

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 National Insurance Contributions (NICs) liability to the individual, or it will recover any NICs paid in this regard upon the exercise of an option from the individual.

**BONUS SCHEMES AND BENEFITS IN KIND**

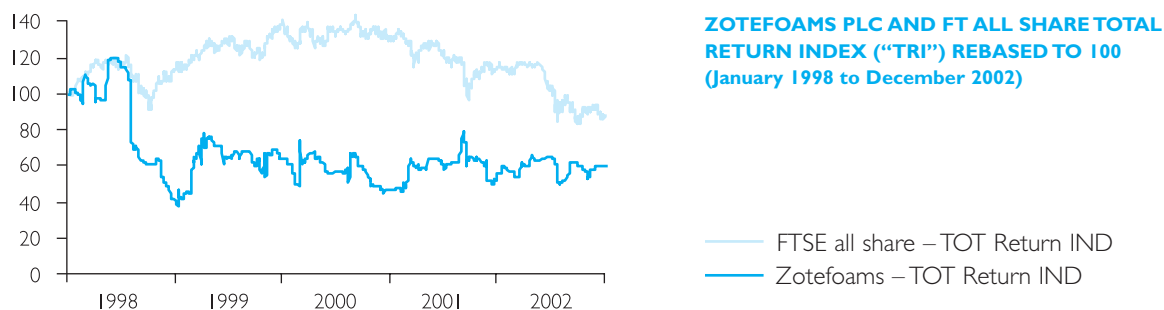
Executive Directors are eligible for a discretionary bonus based on a common profit before tax performance threshold which was set by the Remuneration Committee. In 2002 this threshold was not met and there was no payout under this scheme.

In addition executive Directors are eligible for a performance related payment under the Company's Profit Sharing Scheme which is open to UK based employees. The benefit attributable to participants each year is based on adjusting a pool of value in relation to the change in profit. For 2002 there was no pay out under this scheme.

The principal benefits in kind provided to Directors include a cash allowance in lieu of a company car and private healthcare insurance. No benefits are pensionable.

**TOTAL SHAREHOLDER RETURN**

The following graph charts the total cumulative shareholder return (share price movements plus dividends reinvested) of the Company since 1 January 1998. It is compared to the FTSE all-share index which the Board believes is the most relevant for a company of Zotefoams' size.

**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, other than the Director whose remuneration is being determined.

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.

**REPORT OF THE BOARD OF DIRECTORS' REMUNERATION****INFORMATION SUBJECT TO AUDIT****DIRECTORS' EMOLUMENTS**

Remuneration in £	Basic salary /fees	Bonus	Car allowance	Other benefits	Total 2002	Comparable 2001
W H Fairservice	48,300	—	—	1,701	50,001	72,141
D B Stirling	112,292	—	10,661	611	123,564	119,599
A Eldrett	86,623	—	9,672	1,106	97,401	96,747
C G Hurst	79,625	—	9,672	677	89,974	89,356
I M Buckley	6,070	—	—	—	6,070	18,725
R H Lawson	1,611	—	—	—	1,611	—
J C Marley	26,275	—	—	—	26,275	21,000
C J Ryan	19,238	—	—	—	19,238	18,725

**Note:**

- 1) Fees, car allowance and other benefits are non-pensionable.
- 2) All executive Directors are entitled to a company car cash allowance as determined by the Remuneration Committee.
- 3) 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) I M Buckley resigned from the Board on 25 April 2002.
- 6) R H Lawson was appointed to the Board on 3 December 2002.
- 7) In 2002 fees paid to J C Marley included an amount of £4,000 in recognition of the additional work he performed for the Company during the year, including the extra responsibilities he assumed between the departure of I M Buckley and the appointment of R H Lawson.

**DIRECTORS' SHAREHOLDINGS**

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

Number of ordinary 5p shares at:	31 December 2002	31 December 2001
W H Fairservice	1,104,082	1,092,392
D B Stirling	28,625	28,625
A Eldrett	958,358	978,358
C G Hurst	16,214	8,553
R H Lawson	5,000	—
J C Marley	40,208	40,208
C J Ryan	20,000	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 2002.

**SHARE OPTIONS**

Options over ordinary shares granted:

Date from	Scheme	As at 31 December 2001	Granted	Lapsed	As at 31 December 2002	Exercise price	Exercisable	Expiry date
D B Stirling	Savings related SOS	9,027	—	9,027	—	108.0p	1.10.2001	1.4.2002
D B Stirling	Savings related SOS	—	12,337	—	12,337	77.0p	1.5.2005	1.11.2005
C G Hurst	Savings related SOS	—	12,337	—	12,337	77.0p	1.5.2005	1.11.2005
D B Stirling	IRASOS	32,085	—	32,085	—	93.5p	23.2.2002	22.2.2009
C G Hurst	IRASOS	32,432	—	—	32,432	92.5p	4.4.2004	3.4.2011
D B Stirling*	Executive SOS	176,470	—	—	176,470	93.5p	24.4.2004	23.4.2011
C G Hurst*	Executive SOS	125,133	—	—	125,133	93.5p	24.4.2004	23.4.2011
D B Stirling**	Executive SOS	—	210,093	—	210,093	80.5p	20.8.2005	19.8.2012
C G Hurst***	Executive SOS	—	148,975	—	148,975	80.5p	20.8.2005	19.8.2012
A Eldrett**	Executive SOS	—	161,731	—	161,731	80.5p	20.8.2005	19.8.2012

**Savings related (SAYE) share option scheme**

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 (SAYE) Share Option Scheme.

**Inland Revenue approved share option scheme (IRASOS)**

These options 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.

**REPORT OF THE BOARD OF DIRECTORS ON DIRECTORS' REMUNERATION****SHARE OPTIONS (CONTINUED)****Executive share option scheme**

These options 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 ending 31 December 2003 indicated by \*, or the three year period ending 31 December 2004 indicated by \*\*.

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 shares 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.

The middle market quoted share price at 31 December 2002 was 85p and the high and low prices during the year were 101p and 74p respectively.

**PENSION SCHEME**

The executive Directors are members of the Zotefoams' Pension Scheme which was open to all eligible employees who joined the Company before 1 October 2001. 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%. From 1 March 2003 these contribution rates have increased to 6.5% for members and 14.1% for the Company.

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**

	Accrued pension in scheme at year end <sup>(1)</sup> £	Gross increase in accrued pension £	Increase in accrued pension net of inflation £	Value of accrued pension at year end <sup>(2)</sup> £	Value of accrued pension at start of the year £	Total change in value over the period <sup>(3)</sup> £
W H Fairservice	15,938	1,881	1,642	200,969	176,116	20,208
D B Stirling	8,641	1,750	1,633	29,075	27,993	(3,563)
A Eldrett	47,070	2,649	1,893	504,076	463,852	36,112
C G Hurst <sup>(5)</sup>	2,829	2,829	2,829	11,367	4,591	3,003

- 1) The pension entitlement shown is that which would be paid annually on retirement at normal retirement age, based on service to the end of year and excluding any increase for inflation.
- 2) Transfer values have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.
- 3) The change in the transfer value includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stockmarket movements. It is calculated after deducting the Director's contributions.
- 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) As C G Hurst had less than two years' service at the start of the year, a zero pension was disclosed at 31 December 2001 as his benefits had not yet vested. The value of the accrued pension at the start of the year is equal to his own contributions.

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, apart from C G Hurst where it would be half the prospective pension that would have been payable on normal retirement. 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 Price Index.

By order of the Board

**J C MARLEY**

NON-EXECUTIVE DIRECTOR AND CHAIRMAN OF THE REMUNERATION COMMITTEE

10 MARCH 2003

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

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

The Operations and Projects Director is directly responsible to the Board for Health and Safety performance and the Technical Manager is responsible for Environmental performance. Site committees meet quarterly at both our sites to consider all SHE matters and Steering Committees, chaired by the Managing Director, also meet quarterly to consider overall performance and the impact of current and impending legislation. A Health and Safety Adviser and an Environmental Adviser support both groups.

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

#### **HEALTH & SAFETY PERFORMANCE**

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

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

During the year the overall safety performance of the Group improved significantly. There were no Reportable Incidents and we reduced the number of minor injuries by 10%. The Board would like to congratulate the employees, and contractors on Zotefoams sites, for their contribution to this achievement.

We take reporting of all incidents very seriously, including “near misses” and plant or equipment damage not resulting in personal injury. All events are investigated by appropriate levels of management to establish root cause and to eliminate re-occurrence wherever possible. The Company also operates an Internal Audit system to supplement the annual audit by accreditation bodies.

#### **ENVIRONMENTAL PERFORMANCE**

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

During 2002 over 80% of environmental incidents were releases of nitrogen gas into the air from bursting disks. While Zotefoams record this as an environmental incident principally on the grounds of utility loss and noise, we consider that the safety of our plant is of primary importance and regard these incidents as evidence that our safety processes are functioning as designed.

No major investigations or environmental incidents occurred during the year.

During 2001 our Croydon site became subject to the Climate Change Levy. We were vociferous in our objection to this levy, which costs close to £100,000 per year after National Insurance rebates. Being classified as a “plastics processor” Zotefoams cannot participate in any voluntary agreements to reduce specific energy consumption and therefore minimise the impact of this tax. Energy costs are approximately 12% of our non-labour variable costs and therefore we believe minimisation of energy consumption is an appropriate ongoing commitment for economic and environmental reasons irrespective of this tax.

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 2002 as follows.

#### **BOARD COMPOSITION AND RESPONSIBILITY**

At the beginning of 2002 the Board structure composed three executive Directors, three independent, non-executive Directors and a non-executive Chairman. WH Fairservice is the Chairman and J C Marley is the senior independent Director.

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.

The Chairman of the Nominations Committee is J C Marley.

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 2002 twelve Board meetings were held, and attendance rate by the Directors for these meetings was 90%. 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 available 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. The corporate website [www.zotefoams.com](http://www.zotefoams.com) contains information on the Company.

#### **ACCOUNTABILITY AND AUDIT**

The Audit Committee meets at least twice a year. It was chaired by IM Buckley until April 2002. R H Lawson became chairman in December 2002 and between Mr Buckley and Mr Lawson, J C Marley served as temporary chairman. 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. 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.

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.

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.

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 Company and 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.

We have audited the financial statements on pages 24 to 38. We have also audited the information in the Directors' remuneration report that is described as having been audited.

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

#### **RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

The Directors are responsible for preparing the annual report and Directors' remuneration report. As described on page 22 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 whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. 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 regarding Directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on pages 20 and 21 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 the unaudited part of the Directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

#### **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 and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances consistently applied and adequately disclosed.

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

#### **OPINION**

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2002 and of the profit of the Group for the year then ended; and
- the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

**KPMG AUDIT PLC**  
 CHARTERED ACCOUNTANTS  
 REGISTERED AUDITOR  
 CRAWLEY  
 10 MARCH 2003

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**CONSOLIDATED PROFIT AND LOSS ACCOUNT**  
for the year ended 31 December 2002

	Note	2002			Restated 2001		
		Pre exceptional item £000	Exceptional item (note 3) £000	Post exceptional Item £000	Pre exceptional item £000	Exceptional item (note 3) £000	Post exceptional Item £000
<b>Turnover – continuing operations</b>	2	23,468	—	23,468	22,975	—	22,975
Cost of sales		(17,242)	2,155	(15,087)	(16,227)	(2,607)	(18,834)
<b>Gross profit</b>		6,226	2,155	8,381	6,748	(2,607)	4,141
Distribution costs		(1,923)	(36)	(1,959)	(1,984)	(135)	(2,119)
Administrative expenses		(2,152)	165	(1,987)	(1,845)	(326)	(2,171)
Other operating income		—	3,464	3,464	—	—	—
<b>Operating profit – continuing operations</b>		2,151	5,748	7,899	2,919	(3,068)	(149)
Profit on disposal of fixed assets		—	875	875	—	3,760	3,760
Profit on ordinary activities before interest and tax		2,151	6,623	8,774	2,919	692	3,611
Interest receivable	6	9	—	9	35	—	35
Interest payable and similar charges	7	(208)	—	(208)	(184)	—	(184)
<b>Profit on ordinary activities before taxation</b>	4	1,952	6,623	8,575	2,770	692	3,462
Tax on profit on ordinary activities	8	(517)	(2,019)	(2,536)	(738)	545	(193)
<b>Profit for the financial year</b>	10	1,435	4,604	6,039	2,032	1,237	3,269
Equity dividends – paid				(906)			(906)
Equity dividends – proposed				(1,813)			(1,813)
<b>Total dividends paid and proposed</b>	9			(2,719)			(2,719)
Retained profit for the financial year	19			3,320			550
<b>Earnings per ordinary share</b>	9	4.0p	—	16.6p	5.6p	—	9.0p
<b>Diluted earnings per ordinary share</b>	9	4.0p	—	16.6p	5.6p	—	9.0p

**CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES**

for the year ended 31 December 2002

	2002 £000	2001 £000
Profit for the financial year	6,039	2,518
Currency translation differences on foreign currency net investments	(730)	308
Total recognised gains and losses relating to the year	5,309	2,826
Prior year adjustment – as explained in note 1	751	—
Total recognised gains and losses recognised since last annual report	6,060	2,826

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**CONSOLIDATED BALANCE SHEET**  
as at 31 December 2002

	Note	2002		Restated 2001	
		£000	£000	£000	£000
<b>Fixed assets</b>					
Tangible assets	11	34,765		33,920	
			34,765		33,920
<b>Current assets</b>					
Stocks	13	3,380		3,540	
Debtors	14	5,625		5,843	
Cash at bank and in hand		372		245	
		9,377		9,628	
Creditors: amounts falling due within one year	15	(6,831)		(8,067)	
<b>Net current assets</b>			2,546		1,561
<b>Total assets less current liabilities</b>			37,311		35,481
Creditors: amounts falling due after more than one year	16		(1,049)		(2,229)
Provisions for liabilities and charges	17		(4,671)		(4,251)
<b>Net assets</b>			31,591		29,001
<b>Capital and reserves</b>					
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		16,066		13,476
<b>Total shareholders' funds – equity</b>	20		31,591		29,001

These financial statements were approved by the Board of Directors on 10 March 2003 and were signed on its behalf by:

**W H FAIRSERVICE**  
CHAIRMAN

**C G HURST**  
FINANCE DIRECTOR

**COMPANY BALANCE SHEET**

as at 31 December 2002

	Note	2002		Restated 2001	
		£000	£000	£000	£000
<b>Fixed assets</b>					
Tangible assets	11	26,985		25,066	
Investments	12	9,492		10,036	
			36,477		35,102
<b>Current assets</b>					
Stocks	13	2,838		2,738	
Debtors	14	5,814		6,261	
Cash at bank and in hand		203		51	
		8,855		9,050	
Creditors: amounts falling due within one year	15	(6,684)		(7,841)	
<b>Net current assets</b>			2,171		1,209
<b>Total assets less current liabilities</b>			38,648		36,311
Creditors: amounts falling due after more than one year	16		(1,049)		(2,229)
Provisions for liabilities and charges	17		(4,573)		(4,259)
<b>Net assets</b>			33,026		29,823
<b>Capital and reserves</b>					
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		17,501		14,298
<b>Total shareholders' funds – equity</b>	20		33,026		29,823

These financial statements were approved by the Board of Directors on 10 March 2003 and were signed on its behalf by:

**W H FAIRSERVICE**  
CHAIRMAN

**C G HURST**  
FINANCE DIRECTOR

27 Zotefoams plc Annual report and financial statements 2002  
**CONSOLIDATED CASH FLOW STATEMENT**  
for the year ended 31 December 2002

	Note	2002		2001	
		£000	£000	£000	£000
<b>Net cash inflow from operating activities</b>	24		<b>10,954</b>		842
<b>Returns on investments and servicing of finance</b>					
Interest received		9		35	
Interest paid – bank and other		(181)		(151)	
– finance leases		(27)		(33)	
			(199)		(149)
<b>Taxation</b>					
Mainstream corporation tax		(566)		(671)	
Overseas tax		39		(49)	
			(527)		(720)
<b>Capital expenditure</b>					
Purchase of fixed assets		(5,197)		(6,065)	
Sale of fixed assets		26		36	
Capital receipts from insurers relating to the fire	3	875		4,049	
			(4,296)		(1,980)
			(2,719)		(2,719)
Cash inflow/(outflow) before financing			<b>3,213</b>		(4,726)
<b>Financing</b>					
Capital element of finance lease payments		(138)		(139)	
New borrowings		—		2,876	
Repayment of loan instalments		(928)		—	
			(1,066)		2,737
Increase/(decrease) in cash in the year			<b>2,147</b>		(1,989)

**RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT**

for the year ended 31 December 2002

	Note	2002 £000	2001 £000
<b>Increase/(decrease) in cash in the year</b>		<b>2,147</b>	(1,989)
Cash outflow/(inflow) from decrease/(increase) in debt and lease finance		<b>1,066</b>	(2,737)
Change in net debt resulting from cash flows		<b>3,213</b>	(4,726)
Translation differences		<b>212</b>	9
<b>Movement in net debt in the year</b>		<b>3,425</b>	(4,717)
<b>Net debt at the start of the year</b>		<b>(5,100)</b>	(383)
<b>Net debt at the end of the year</b>	25	<b>(1,675)</b>	(5,100)

## **I. 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.

### **Change in accounting policy and prior year adjustment**

The adoption of FRS 19 "Deferred Taxation" has increased opening reserves at 1 January 2002 by £0.75 million. Comparative figures have been restated accordingly.

### **Basis of consolidation**

The Group financial statements consolidate the financial statements of the Company and its subsidiary undertakings. 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 is capitalised and amortised to nil by equal annual instalments over its estimated useful life not exceeding 20 years.

### **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.

## 1. ACCOUNTING POLICIES (CONTINUED)

### 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. Deferred taxation is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not been reserved by the balance sheet date, except as otherwise required by FRS 19.

### Turnover

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

### Cash

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

## 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
2002	7,335	2,754	3,121	4,529	5,331	398	23,468
2001	7,791	2,549	2,984	4,588	4,725	338	22,975

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 2001 the expense incurred and insurance proceeds received up to 31 December 2001 were shown in the accounts as an exceptional item. A final settlement of £13.9 million was agreed with insurers in July 2002, of this £6.1 million was received in 2000/1 and £7.8 million in 2002. The expenses incurred in 2002 plus those further expenses which are expected to be incurred have been disclosed as an exceptional item.

	2002 £000	Restated 2001 £000
Stock destroyed	—	(1,215)
Net book value of fixed assets destroyed	—	(941)
Revenue costs incurred	(1,207)	(3,201)
Cash received from insurers	7,830	6,049
Exceptional item before taxation	6,623	692
Tax on exceptional item	(2,019)	545
Exceptional item after taxation	4,604	1,237

The insurance proceeds have not been allocated to specific items by the loss adjusters and Zotefoams' management have therefore allocated these proceeds using their best estimates at the time. Of the £7.8 million received in 2002 management have allocated £3.4 million to revenue cost, £0.9 million to fixed assets destroyed in the fire and the remaining £3.5 million has been treated as compensation for lost sales and allocated to other operating income.



## 8. TAX ON PROFIT ON ORDINARY ACTIVITIES

	2002 £000	Restated 2001 £000
UK corporation tax at 30% (2001: 30%)	190	435
Overseas taxation (including £91,000 credit (2001: £nil) in respect adjustments to prior year)	(40)	36
Adjustment to prior year UK tax charge	168	—
Current taxation	318	471
Deferred taxation	199	267
	<b>517</b>	<b>738</b>
Tax on exceptional item:		
UK corporation tax	1,798	(788)
Deferred tax	221	243
	<b>2,019</b>	<b>(545)</b>
Total tax charge	<b>2,536</b>	<b>193</b>

### Factors affecting the tax charge for the current period

The current charge for the period is lower (2001: lower) than the standard rate of corporation tax in the UK (30%, 2001: 30%). The differences are explained below.

	2002 £000	Restated 2001 £000
Current tax reconciliation		
Profit on ordinary activities before tax	8,575	3,462
Current tax at 30% (2001: 30%)	2,572	1,039
Effects of:		
Expenses not deductible for tax purposes less		
Research and Development tax credits	3	14
Capital allowances for period in excess of depreciation	(553)	(571)
Rollover relief on profit on disposal of property	—	(725)
Higher tax rates on overseas earnings	17	(74)
Adjustments to tax charge in respect of previous periods	77	—
Total current tax charge	<b>2,116</b>	<b>(317)</b>

## 9. DIVIDENDS AND EARNINGS PER SHARE

	2002 £000	2001 £000
Interim dividend of 2.5p (2001: 2.5p) net per 5p ordinary share	906	906
Proposed final dividend of 5.0p (2001: 5.0p) net per 5p ordinary share	1,813	1,813
	<b>2,719</b>	<b>2,719</b>
<b>Dividends per ordinary share</b>	<b>7.5p</b>	<b>7.5p</b>

### Earnings per ordinary share

Earnings per ordinary share is calculated by dividing profit after tax of £6,039,000 (2001: £3,269,000) 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.

	2002	2001
Average number of ordinary shares issued	36,255,772	36,255,772
Deemed issued for no consideration	61,204	9,821
Diluted	<b>36,316,976</b>	<b>36,265,593</b>

### 9. DIVIDENDS AND EARNINGS PER SHARE (CONTINUED)

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	Number of shares under option	
		2002	2001
23 February 2002	93.5p	—	32,085
4 April 2004	92.5p	64,864	64,864
24 April 2004	93.5p	301,603	301,603
21 August 2004	107.5p	236,666	236,666
1 June 2005	77.0p	261,631	—
20 August 2005	80.5p	794,685	—

The average fair value of one ordinary share during the year was considered to be 90.0p (2001: 95.0p).

### 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 £6,242,000 (2001 restated: £4,962,000).

### 11. TANGIBLE FIXED ASSETS

	Freehold land and buildings £000	Plant and machinery £000	Computer equipment and vehicles £000	Total £000
<b>The Group</b>				
Cost				
At 1 January 2002	12,624	33,732	1,832	48,188
Additions	2,113	2,371	326	4,810
Foreign exchange adjustments	(463)	(381)	(8)	(852)
Disposals	—	(19)	(55)	(74)
<b>At 31 December 2002</b>	<b>14,274</b>	<b>35,703</b>	<b>2,095</b>	<b>52,072</b>
Depreciation				
At 1 January 2002	1,304	12,053	911	14,268
Charge for the year	626	2,136	322	3,084
On disposals	—	(11)	(34)	(45)
<b>At 31 December 2002</b>	<b>1,930</b>	<b>14,178</b>	<b>1,199</b>	<b>17,307</b>
Net book value				
<b>At 31 December 2002</b>	<b>12,344</b>	<b>21,525</b>	<b>896</b>	<b>34,765</b>
Net book value of assets held under finance leases included in above	—	—	396	396
At 31 December 2001	11,320	21,679	921	33,920
<b>Company</b>				
Cost				
At 1 January 2002	7,941	29,164	1,746	38,851
Additions	2,130	2,100	301	4,531
Disposals	—	(19)	(55)	(74)
<b>At 31 December 2002</b>	<b>10,071</b>	<b>31,245</b>	<b>1,992</b>	<b>43,308</b>
Depreciation				
At 1 January 2002	1,258	11,629	898	13,785
Charge for the year	458	1,832	293	2,583
On disposals	—	(11)	(34)	(45)
<b>At 31 December 2002</b>	<b>1,716</b>	<b>13,450</b>	<b>1,157</b>	<b>16,323</b>
Net book value				
<b>At 31 December 2002</b>	<b>8,355</b>	<b>17,795</b>	<b>835</b>	<b>26,985</b>
Net book value of assets held under finance leases included in above	—	—	396	396
At 31 December 2001	6,683	17,535	848	25,066

Freehold land and buildings in the Group include £11,256,000 (2001: £9,511,000) of depreciable assets. Freehold land and buildings in the Company include £7,895,000 (2001: £5,785,000) of depreciable assets.

## 12. FIXED ASSET INVESTMENTS

	Company	
	2002 £000	2001 £000
Shares in Group undertakings – at cost	4,505	4,505
Loan to Zotefoams Fabrications Limited	4,987	5,531
	<b>9,492</b>	<b>10,036</b>

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	
	2002 £000	2001 £000	2002 £000	2001 £000
Raw materials and consumables	1,673	1,442	1,673	1,441
Work in progress	760	1,000	734	826
Finished goods and goods for resale	947	1,098	431	471
	<b>3,380</b>	<b>3,540</b>	<b>2,838</b>	<b>2,738</b>

## 14. DEBTORS

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
Amounts falling due within one year:				
Trade debtors	5,473	5,154	4,430	3,932
Amounts owed by Group undertakings	—	—	1,282	1,685
Other debtors	78	208	44	187
Corporation tax debtor	—	428	—	428
Prepayments and accrued income	74	53	58	29
	<b>5,625</b>	<b>5,843</b>	<b>5,814</b>	<b>6,261</b>

**15. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR**

	Group				Company			
	2002		2001		2002		2001	
	£000	£000	£000	£000	£000	£000	£000	£000
Bank overdrafts		7		2,011		—		1,891
Trade creditors		771		1,195		767		1,202
Other creditors including taxation and social security:								
Mainstream corporation tax	1,165		—		1,156		—	
Other taxation and social security	132		158		131		153	
		1,297		158		1,287		153
Other creditors		339		445		272		368
Obligations under finance leases		119		139		119		139
Bank loans		872		966		872		966
Accruals and deferred income		1,613		1,340		1,554		1,307
Dividends proposed		1,813		1,813		1,813		1,813
		<b>6,831</b>		<b>8,067</b>		<b>6,684</b>		<b>7,841</b>

**16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR**

	Group and Company	
	2002 £000	2001 £000
Finance leases:		
Amounts falling due in more than one year but less than two years	119	139
Amounts falling due in more than two years but less than five years	58	155
Bank loans (see note 21):		
Amounts falling due in more than one year but less than two years	872	966
Amounts falling due in more than two years but less than five years	—	969
	<b>1,049</b>	<b>2,229</b>

**17. PROVISIONS FOR LIABILITIES AND CHARGES**

	Deferred taxation — restated	
	Group £000	Company £000
<b>The Group and Company</b>		
At 1 January 2002	4,251	4,259
Charge for the year in the profit and loss account	420	314
<b>At 31 December 2002</b>	<b>4,671</b>	<b>4,573</b>

Deferred tax is provided as follows:

	Group		Company	
	2002 £000	2001 — restated £000	2002 £000	2001 — restated £000
Difference between accumulated depreciation and amortisation and capital allowances	4,671	4,251	4,573	4,259
	<b>4,671</b>	<b>4,251</b>	<b>4,573</b>	<b>4,259</b>

Deferred tax is provided at a rate of 30% (2001: 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

	2002 £	2001 £
Authorised		
At 31 December		
Equity: 56,000,000 ordinary shares of 5p shares	<b>2,800,000</b>	2,800,000
Allotted, called-up and fully paid		
At 31 December		
Equity: 36,255,772 ordinary shares of 5p shares	<b>1,812,789</b>	1,812,789

Details of share options are described in note 9 to the accounts on page 32.

## 19. STATEMENT OF MOVEMENTS IN RESERVES AND SHARE CAPITAL

	Profit and loss £000	Capital redemption £000	Share premium £000	Share capital £000
The Group				
At 1 January 2002 – restated	13,476	5	13,707	1,813
Other recognised losses	(730)	—	—	—
Retained profit for year	3,320	—	—	—
<b>At 31 December 2002</b>	<b>16,066</b>	<b>5</b>	<b>13,707</b>	<b>1,813</b>
The Company				
At 1 January 2002 – restated	14,298	5	13,707	1,813
Other recognised losses	(320)	—	—	—
Retained profit for year	3,523	—	—	—
<b>At 31 December 2002</b>	<b>17,501</b>	<b>5</b>	<b>13,707</b>	<b>1,813</b>

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	
	2002 £000	2001 – restated £000	2002 £000	2001 – restated £000
Profit for the financial year	<b>6,039</b>	2,518	<b>6,242</b>	4,211
Dividends	<b>(2,719)</b>	(2,719)	<b>(2,719)</b>	(2,719)
Retained profit/(loss) for the financial year	<b>3,320</b>	(201)	<b>3,523</b>	1,492
Translation differences	<b>(730)</b>	308	<b>(320)</b>	—
Prior period adjustment – as explained in note 1	—	751	—	751
Net addition to shareholders' funds	<b>2,590</b>	858	<b>3,203</b>	2,243
Opening shareholders' funds	<b>29,001</b>	28,143	<b>29,823</b>	27,580
Closing shareholders' funds	<b>31,591</b>	29,001	<b>33,026</b>	29,823

## 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 2002.

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

## 21. FINANCIAL INSTRUMENTS (CONTINUED)

### 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:

	2002			2001		
	Fixed rates £000	Variable rates £000	Total £000	Fixed rates £000	Variable rates £000	Total £000
Sterling	295	7	302	433	2,011	2,444
US dollar	—	1,745	1,745	—	2,901	2,901
	<b>295</b>	<b>1,752</b>	<b>2,047</b>	<b>433</b>	<b>4,912</b>	<b>5,345</b>

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 34.

The Group has a short-term facility of £5.0 million which is freely transferable and convertible into sterling. This facility expires in February 2004 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 Euros. 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

The fair value of all financial assets and liabilities is not materially different from the carrying value. Therefore the fair value is not separately disclosed. At 31 December 2002 the Group had forward exchange contracts with a nil carrying value and a fair value, based on estimated market values, of £1.0 million (2001: £nil).

## 22. COMMITMENTS

	2002 £000	2001 £000
(i) Capital contracts at the end of the financial year for which no provision has been made	772	3,305
(ii) The Group has annual commitments under non-cancellable operating leases which expire between two and five years:		
Other operating leases	181	301
(iii) As at 31 December the Group had foreign currency forward exchange contracts amounting to:	999	—

The above amounts apply to the Company as well as the Group apart from Capital Commitments which includes £125,000 (2001: £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. Whilst the Group continues to account for pension costs in accordance with Statement of Standard Accounting Practice 24 "Accounting for Pension costs", under FRS 17 "Retirement benefits" the following transitional disclosures are required:

A full actuarial valuation was carried out at 6 April 2002 and updated by a qualified independent actuary on a FRS 17 basis to 31 December 2002.

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 2002 % p.a.	At year end 31 December 2001 % p.a.
Rate of general increase in salaries	3.85	4.50
Rate of increase of pensions in payment	2.25	2.25
Discount rate	5.47	5.83
Inflation assumption	2.35	2.50

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:

	Long-term rate of return 2002	Value at 31 December 2002 £000	Long-term rate of return 2001	Value at 31 December 2001 £000
Equities	7.52	6,579	7.95	7,875
Bonds	5.00	1,281	5.39	1,487
Other – Cash	4.00	324	4.50	414
		8,184		9,776
Present value of scheme liabilities		(11,497)		(9,897)
Deficit in the scheme		(3,313)		(121)
Related deferred tax asset		994		36
Net pension liability		(2,319)		(85)

Movement in deficit in scheme during the year

	At year end 31 December 2002 £000
Deficit in scheme at beginning of year	(121)
Current service cost	(503)
Contributions paid	423
Past service cost	—
Other finance income	148
Actuarial loss	(3,260)
Deficit in the scheme at end of year	(3,313)

### 23. PENSION SCHEME (CONTINUED)

If FRS 17 had been fully adopted in these financial statements the pension costs for the defined benefit scheme would have been:

Analysis of other pension costs charged in arriving at operating profit

	2002 £000
Current service cost	(503)
Past service cost	—
	<b>(503)</b>

Analysis of amounts included in other finance income/costs

	2002 £000
Expected return on pension scheme assets	737
Interest on pension scheme liabilities	(589)
	<b>148</b>

Analysis of amount recognised in statement of total recognised gains and losses

	2002 %	2002 £000
Actuarial return less expected return on scheme assets		(2,646)
Percentage of year end scheme assets	(32)	
Experience gains and losses arising on scheme liabilities		(270)
Percentage of present value of year end scheme liabilities	(2)	
Changes in assumptions underlying the present value of scheme liabilities		(344)
Percentage of present value of year end scheme liabilities	(3)	
Actuarial loss recognised in statement of total recognised gains and losses	(28)	(3,260)

In 2002 the Company paid a contribution of 12% of pensionable salaries, in addition to the employees' contribution of 5%. Following the actuarial valuation at 6 April 2002, it was agreed that the Company contribution would increase to 14.1% of pensionable salaries and the employee contribution to 6.5% from 1 March 2003. The total company contributions to the scheme paid in the year amounted to £423,099.

In addition there is a stakeholder scheme for UK employees who joined the Group after 1 October 2001. The contributions paid by the Group to the scheme for the year ended 31 December 2002 were £2,732.

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

### 24. RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2002 £000	2001 £000
Operating profit/(loss)	7,899	(149)
Depreciation charge	3,084	2,458
Loss on disposal of assets	4	—
Decrease/(increase) in stocks	120	(1,394)
(Increase)/decrease in debtors	(274)	184
Increase/(decrease) in creditors	121	(257)
Net cash inflow from operating activities	<b>10,954</b>	<b>842</b>

Insurance proceeds relating to the fire for £7.8 million have been received during 2002. £6.9 million of this has been allocated to revenue and the remainder to capital as described in note 3 to the accounts on page 29. In 2001 £6.0 million was received from the insurers of which £1.3 million was allocated to revenue and the remainder to capital.

### 25. ANALYSIS OF CHANGES IN NET (DEBT)/FUNDS

	At 1 January 2002 £000	Cashflow £000	Translation differences £000	At 31 December 2002 £000
Cash at bank and in hand	245	146	(19)	<b>372</b>
Bank overdrafts	(2,011)	2,000	4	<b>(7)</b>
Obligations under finance leases	(433)	138	—	<b>(295)</b>
Bank loans	(2,901)	929	227	<b>(1,745)</b>
	<b>(5,100)</b>	<b>3,213</b>	<b>212</b>	<b>(1,675)</b>

Notice is hereby given that the Annual General Meeting of Zotefoams plc (the "Company") will be held at the offices of Zotefoams plc, 675 Mitcham Road, Croydon CR9 3AL on 1 May 2003 at 10.00a.m. for the following purposes:

#### **ORDINARY BUSINESS**

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

1. To receive and adopt the audited accounts and the Directors' and auditors report for the year ended 31 December 2002.
2. To receive and approve the Report on Directors' Remuneration for the year ended 31 December 2002.
3. To declare a final dividend for the year ended 31 December 2002 of 5.0p net per ordinary share, such dividend to be payable on 21 May 2003 to shareholders on the register at the close of business on 22 April 2003.
4. To re-elect Mr A Eldrett as a Director who retires by rotation.
5. To re-elect Mr C J Ryan as a Director who retires by rotation.
6. To re-elect Mr R H Lawson as a Director having been appointed since the last Annual General Meeting.
7. That KPMG Audit Plc be and are hereby re-appointed as auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at which accounts are laid before the Company at a remuneration to be fixed by the Directors.
8. That the Board be and is hereby generally and unconditionally authorised to exercise all powers of the Company to allot relevant securities (within the meaning of Section 80(2) of the Companies Act 1985) of the Company up to an aggregate nominal amount of £604,263 to such persons and on such terms as it thinks fit provided that this authority shall expire on the date of the next Annual General Meeting after the passing of this resolution or 15 months after the passing of this resolution (whichever shall be earlier) save that the Company may before such expiry make such an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Board may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired, such authority to be in substitution for any existing authorities conferred on the Board pursuant to Section 80 of the Companies Act 1985.

#### **SPECIAL BUSINESS**

To consider and, if thought fit, to pass the following resolutions which will be proposed as special resolutions:

9. That subject to the passing of resolution 8 the Board be and is hereby empowered pursuant to Section 95 of the Companies Act 1985 to allot equity securities (within the meaning of Section 94(2) of the said Act) for cash pursuant to the authority conferred by the previous resolution as if Section 89(1) of the said Act did not apply to any such allotment provided that this power shall be limited:
  - (a) to the allotment of equity securities in connection with a rights issue or open offer in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as maybe) to the respective numbers of ordinary shares held by them subject only to such exclusions or other arrangements as the Directors may consider appropriate to deal with fractional entitlements or legal or practical difficulties under the laws, rules or regulations of any jurisdiction, stock exchange or other regulatory body whatsoever; and
  - (b) to the allotment (otherwise than pursuant to sub-paragraph (a) above) for cash of equity securities up to an aggregate nominal value of £90,639,and shall expire on the date of the next Annual General Meeting of the Company after the passing of this resolution or 15 months after the passing of this resolution (whichever shall be earlier) save that the Company may before such expiry make such an offer or agreement which would or might require equity securities to be allotted after such expiry and the Board may allot equity securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired, such authority to be in substitution for any existing authorities conferred on the Board pursuant to Section 95 of the Companies Act 1985.

10. That the Company be and is hereby generally and unconditionally authorised for the purposes of Section 166 of the Companies Act 1985 to make one or more market purchases (within the meaning of Section 163(3) of the said Act) on the London Stock Exchange plc of ordinary shares of 5p each in the capital of the Company provided that:
- (a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 3,625,577 (representing 10% of the Company's issued ordinary share capital);
  - (b) the minimum price which may be paid for such shares is 5p per share (exclusive of any applicable taxes and expenses);
  - (c) the maximum price (exclusive of any applicable taxes and expenses) which may be paid for an ordinary share shall not be more than 5% above the average of the market values for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the date on which the ordinary share is purchased;
  - (d) unless previously renewed, varied or revoked, the authority hereby conferred shall expire at the conclusion of the Company's next Annual General Meeting or 15 months from the date of passing this resolution, if earlier; and
  - (e) the Company may make a contract or contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make a purchase of ordinary shares in pursuance of any such contract or contracts.
11. That the Articles of Association for the Company be and they are hereby amended by inserting the following wording into Article 147 after the end of the first sentence: "Provided that the Company may destroy any such type of document at a date earlier than that authorised by this Article if a copy of such document is retained on microfilm or by other similar means which such copy is retained until the expiration of the period applicable to the destruction of the original document."

By order of the Board

**C G HURST**  
SECRETARY  
REGISTERED OFFICE  
675 MITCHAM ROAD  
CROYDON CR9 3AL  
10 MARCH 2003

#### **NOTES**

- (i) Shareholders are entitled to attend and vote at this meeting and may appoint one or more proxies to attend and on a poll, vote instead of him. A proxy need not be a member of the Company. A form of proxy is enclosed for the use of members and must reach the office of the Registrars of the Company not less than 48 hours prior to the start of the meeting.
- (ii) The appointment of a proxy will not prevent the member from subsequently attending and voting at the meeting in person.
- (iii) Copies of the following will be available for inspection at the registered office of the Company, 675 Mitcham Road, Croydon CR9 3AL during normal business hours from the date of the above Notice until the date of the Annual General Meeting and at the place of the meeting for 15 minutes prior to and until the termination of the Meeting:
  - (a) The Register of Directors' share interests; and
  - (b) Copies of executive Directors' service contracts.
- (iv) Only those members registered in the register of members of the Company as at 6p.m. on 29 April 2003 will be entitled to attend or vote at the meeting in respect of the number of ordinary shares of 5p registered in their respective names at that time. Changes to entries on the register after 6p.m. on 29 April 2003 will be disregarded in determining the rights of any person to attend or vote at the meeting.

	2002 £m	Restated 2001 £m	2000 £m	1999 £m	Restated 1998 £m
Turnover	23.5	23.0	20.8	22.4	24.2
Operating profit (excluding exceptional items)	2.2	2.9	2.4	5.7	7.3
Profit before tax (excluding exceptional items)	2.0	2.8	2.3	5.8	8.0
Profit before tax (including exceptional items)	8.6	3.5	2.3	5.8	8.0
Profit after tax	6.0	3.3	1.8	4.1	5.7
Capital expenditure	5.2	6.1	6.1	2.7	4.3
Net cash flow from operating activities	11.0	0.8	5.5	7.7	9.2
Dividends per ordinary share (p)	7.5	7.5	7.5	7.5	7.2
Earnings per share excluding exceptional items (p)	4.0	5.6	4.8	11.2	15.6
Earnings per share including exceptional items (p)	16.6	9.0	4.8	11.2	15.6

## FINANCIAL CALENDAR

Annual General Meeting	1 May 2003
Payment of final dividend	21 May 2003 to shareholders on the register at the close of business on 22 April 2003
Announcement of 2003 interim results	August 2003
Payment of interim dividend	September 2003
Announcement of 2003 results	March 2004

## REGISTRARS

Enquiries concerning the holding of ordinary shares in the Company should be addressed to the Registrars who should also be notified of any changes in a holder's address.  
 The Registrars are: Computershare Investor Services Plc, PO Box 82, The Pavillions, Bridgwater Road, Bristol, BS99 7NH.

## WEBSITE

The Company has a website ([www.zotefoams.com](http://www.zotefoams.com)) which provides information on the business and products.



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 a member of the flathill communications group plc  
[www.flathillplc.com](http://www.flathillplc.com)

## PICTURES OF PRODUCTS COURTESY OF:

Cellutec – France  
 Recticel – Holland  
 Rak-gard International – UK  
 Zfoam – Spain  
 CF Sports – UK

**Zotefoams plc**

675 Mitcham Road  
Croydon  
CR9 3AL  
United Kingdom

Telephone: +44 (0)20 8664 1600  
Telefax: +44 (0)20 8664 1616  
E-mail: [info@zotefoams.com](mailto:info@zotefoams.com)  
Website: [www.zotefoams.com](http://www.zotefoams.com)