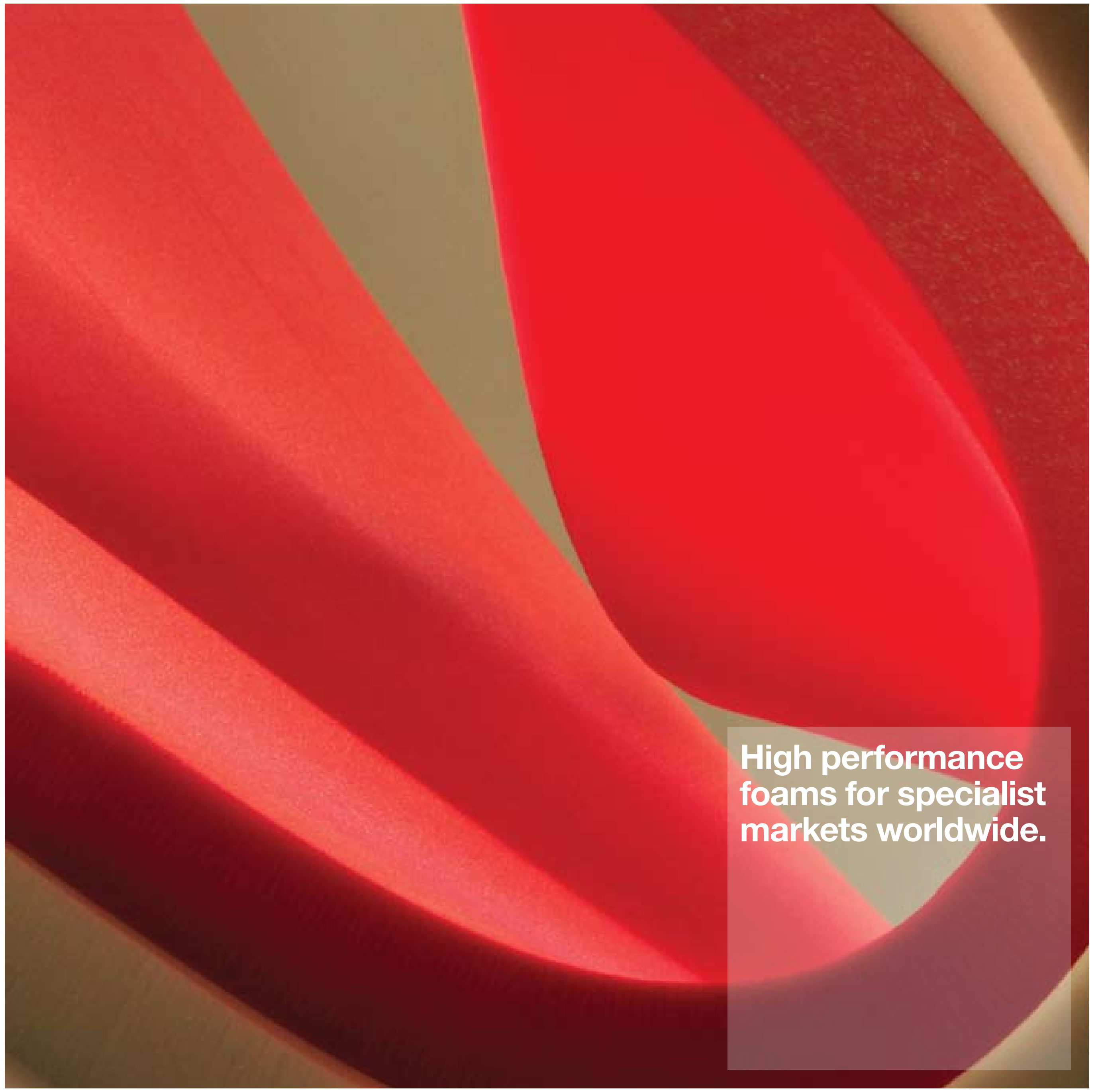
ZOTEFOAMS

Annual Report and Accounts 2010

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




## Overview and Business Review

**The key strategic, financial and operational developments during the year.**

### Overview



### Business Review



## Directors and Governance

**The report from the Directors, our governance and remuneration reports.**

### Corporate Information



## Financials

### Financial Statements

# A year of growth

**2010 saw an improved operational performance across all business segments. Revenues recovered strongly in more established markets and we were pleased to see higher rates of growth from emerging markets and our HPP product range.**

## Increased demand

We have experienced increased demand for premium applications, notably Azote® foam is used in soft closure mechanisms to meet the high standards set by major kitchen manufacturers.

Our foams provide:
- Consistent cushioning
- Resistance to compression set
- Long life

## Adding flexibility

Our capital programme will improve manufacturing flexibility and help us respond more swiftly to ever increasing demand.

In late 2010 we commenced installation of a new expansion autoclave. This investment will not only increase production capacity but also improve our manufacturing flexibility and our ability to respond more swiftly to market demand.

## Satisfying market leaders needs

We increased our global presence in providing puncture-resistant buoyancy for floating hoses used to load and discharge crude oil and transport dredged debris.

Our foams provide:
- High strength to weight ratio
- High flexibility
- Insulating properties

## Expanding horizons

Our materials are constantly being put to use in new niche applications.

UFP increased their BioShell™ product range, a frozen bag container system produced from laminated Azote® foams: this protects single use bags in biopharmaceutical processing.

Our foams provide:
- Resilience and cushioning
- Thermoformability
- Impact resistant at –70°C

## Continued capital investment

Central to Zotefoams growth strategy is new capital investment to meet anticipated market trends.

2010 saw further investment in our extrusion line dedicated to the production of ZOTEK® N, polyamide foams that offer outstanding high temperature performance and excellent resistance to hydrocarbons.

## Global market development

From European design through to technical support for Far East manufacturing our client partnering is becoming increasingly sophisticated.

Evazote® foam gives 15% weight saving and 20% vibration reduction in saddles for professional cycle racing.

Our foams provide:
- Weight saving
- Cushioning
- Excellent compression recovery

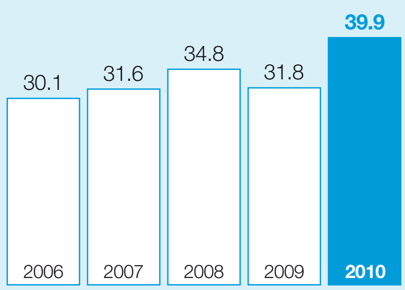
## Operational highlights

- **Revenue increased 25% to £39.88 million (2009: £31.82 million)**
- **Profit before tax and exceptional items increased 49% to £4.70 million (2009: £3.16 million)[1]**
- **HPP (High-Performance Polymers) foams sales grew 51% to £2.49 million (2009: £1.64 million)**
- **Turnover growth of 79% recorded in Asian markets**
- **Net cash of £1.86 million at 31 December 2010 (net debt of £0.43 million at 31 December 2009)[2]**
- **5% increase in the proposed final dividend to 3.15p per ordinary share (2009: 3.00p)**

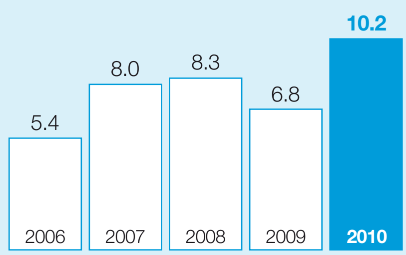
1 Profit before tax and after exceptional items was £5.80 million (2009: £2.75 million)
2 Net cash/net debt are defined as cash less bank overdrafts and other bank borrowings.

## Financial highlights

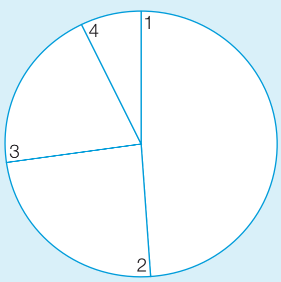
**Revenue**
(£m)




**Earnings per share**
(excluding exceptional items)
(pence)

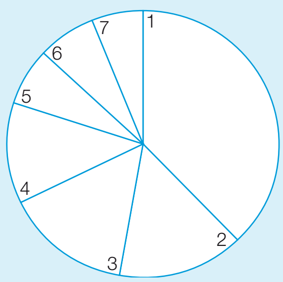



**Revenue by region**




1. Continental Europe **49%**
2. North America **24%**
3. UK and Eire **20%**
4. Rest of the World **7%**

**Revenue by market**




1. Packaging **38%**
2. Industrial **15%**
3. Transportation **15%**
4. Sports and Leisure **12%**
5. Building **7%**
6. Medical **7%**
7. Other **6%**

# Strategy

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

## Key objectives:

**Zotefoams measures its development and performance on four key objectives that represent the core elements of our strategy. We intend to:**

## Grow

**Grow sales in our polyolefin business**

**Action:**

Turnover in our Azote® polyolefin business grew by 22% in 2010 aided by the recovery in economic conditions and our investment in commercial resource, particularly in Asia. Going forward we have set an objective for polyolefin sales growth to exceed twice the average rate of global GDP growth.

## Develop

**Develop a High-Performance Polymers portfolio to deliver enhanced margins**

**Action:**

HPP sales grew by 51% in 2010 and currently represent 6% of sales. We now have five commercially launched product ranges within this segment following our first sales of Pebaxfoam® and receipt of our first order for microZOTE® roll foams early in 2011.

## Improve

**Improve our operating margins**

**Action:**

Group operating margins, excluding exceptional items and Mucell Extrusion LLC increased to 12.4% (2009: 10.7%) our highest level in recent years.

## Profit

**Improve our return on capital employed**

**Action:**

Pre-tax return on average capital employed, excluding exceptional items and MuCell Extrusion LLC, increased from 11.5% to 16.9%.

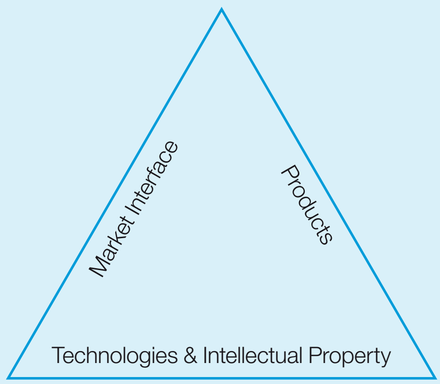
# Our business model

## Our business model is designed to harness our unique manufacturing technologies and intellectual property to produce added value products that meet or anticipate market requirements.

We work closely with specifiers, users and converters in functional and geographic markets, where we are able to identify opportunities at an early stage, tapping into global trends.

Our premium polyolefin block foam business is reinforced by a portfolio of products based on advanced polymers and roll foam materials.

Our complementary intellectual property embraced in our portfolio of manufacturing technologies offers exciting prospects for future growth.




### Market Interface

26 people in direct sales and marketing
Direct sales to 41 countries
Indirect sales to 13 countries
Conducting business in 10 languages

### Products

Polyethylene foams
EVA copolymer foams
Metallocene polyethylene foams
Fluoropolymer foams
Polyamide foams
Roll foams

### Technologies & Intellectual Property

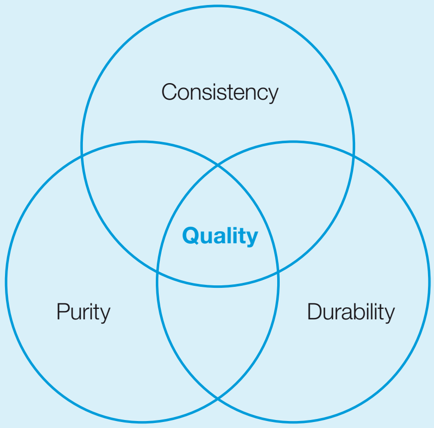
Autoclave foam manufacturing process
MuCell® foam expansion
Growing patent portfolio
Owned and licensed trademarks:
Azote®, Plastazote®, Evazote®, ZOTEK®, microZOTE®, Pebaxfoam®, MuCell®, T-Tubes®

## Our competitive advantage

**The physical properties of our foams enable us to offer a wide range of materials with a broad spectrum of performance attributes, suitable for a vast number of diverse applications across a wide spread of industries, throughout North America, Europe and Asia.**

**Light weight, pure, low-odour, consistent, with strong aesthetic appeal thanks to their deep colours and rich textures.**

**Our HPP products capture the fundamental attributes of the polymers, creating foams with unique properties.**




## Characteristics:

**Zotefoams' block foam materials are manufactured using pure nitrogen in a unique process, giving our foams significant advantages over competitive products. They are both easy and economical to process and provide added-value opportunities for foam converters around the world.**

**Quality**

**A Unique Process**

Our unique three-step manufacturing process with its nitrogen expansion technology produces cross-linked, closed-cell block foams of the highest quality that are consistent, light-weight and low-odour. The three stages of the manufacturing process are: extrusion, high-pressure gassing and final stage expansion.

**Purity**

**Safe, clean and hygienic**

Using only pure nitrogen to expand our foams provides a host of beneficial features that make our foams ideal for medical, food-safe and other clean applications.

**Skin compatible**

The foams have excellent skin compatibility, are MRI/CT/X-Ray lucent, have very little odour and contain no VOC or potentially corrosive chemical blowing agents.

**Durability**

**Long-life protection**

The combination of cross-linking and cell size uniformity produces foams with outstanding durability that are highly suitable for long-life use in a variety of protection applications.

**Multi-trip**

Ideal for multi-trip returnable packaging applications, Azote® foams represent a cost effective and greener alternative to expanded polystyrene foam packaging. The individual cells maintain their integrity for improved resistance to surface marking.

**Consistency**

**Regular cell structure**

Our foams are characterised by their consistent cell size and structure, features that improve mechanical properties and aesthetic appeal.

**Efficient utilisation**

The consistency of our foams enables efficient material utilisation and provides more reliable colour density.

# Managing Director's Discussion on Strategy
## David Stirling

**Zotefoams produces products which are significantly differentiated from our nearest competitors.**

### Q: 2010 saw a strong increase in both sales and profits. Why?

**A:** Sales increased as a result of recovery in global markets and our investment in specific areas such as Asia, where we now have a sales team of five people, and our High-Performance Polymers ('HPP') business. Turnover of our MuCell Extrusion LLC ('MEL') joint venture was required by International Accounting Standards to be consolidated in our accounts from 1 July 2010 although, due to the seasonality and nature of this business, the impact of this was less than 2% of global sales for the year. Profits rebounded strongly as we capitalised on the growth in sales while continuing to manage costs tightly.

### Q: Is management of costs important to Zotefoams?

**A:** Raw materials and energy account for approximately one third of Zotefoams' 2010 turnover. Materials are mainly commodity polymers where prices change very frequently. Reduction of costs to maintain and improve margins while delivering value to our customers is important and we have initiatives in place to improve our cost base, production yields and energy efficiency. In 2010 approximately one third of our capital expenditure was in support of these initiatives.

### Q: What drives value in your business?

**A:** Due to our proprietary technologies Zotefoams has a unique position in our markets. We produce products which are significantly differentiated from our nearest competitors and our strategy of investing in new, unique products further differentiates us, providing more opportunities to add value for our customers in highly specialist markets.

# Zotefoams has consistently invested in production capacity, market resource and product research and development.

### Q: Why invest in a ‘portfolio’ of products rather than focus on a core product line?

**A:** A diversified portfolio of synergistic technologies provides us with a range of opportunities. Zotefoams operates worldwide supplying a variety of end uses. We have a significant investment in technology and sales and marketing resources. We are therefore uniquely positioned to identify global trends, such as increased fire safety requirements which led to our ZOTEK® F fluoropolymer foams, and develop products to capitalise on these trends.

We have five significant projects aggregated together in the HPP foam segment. ZOTEK® F, fluoropolymer foams and T-Tubes®, an end use product made from these foams, represent £2.45m (or 98%) of sales and both are profitable. Sales of ZOTEK® N nylon foam, developed to meet high temperature needs, are at a very early stage where costs, in particular sales and marketing costs, substantially exceed revenues. Other projects are at scale-up or development stage and two of these are expected to generate revenues in 2011.

### Q: What about MuCell Extrusion LLC?

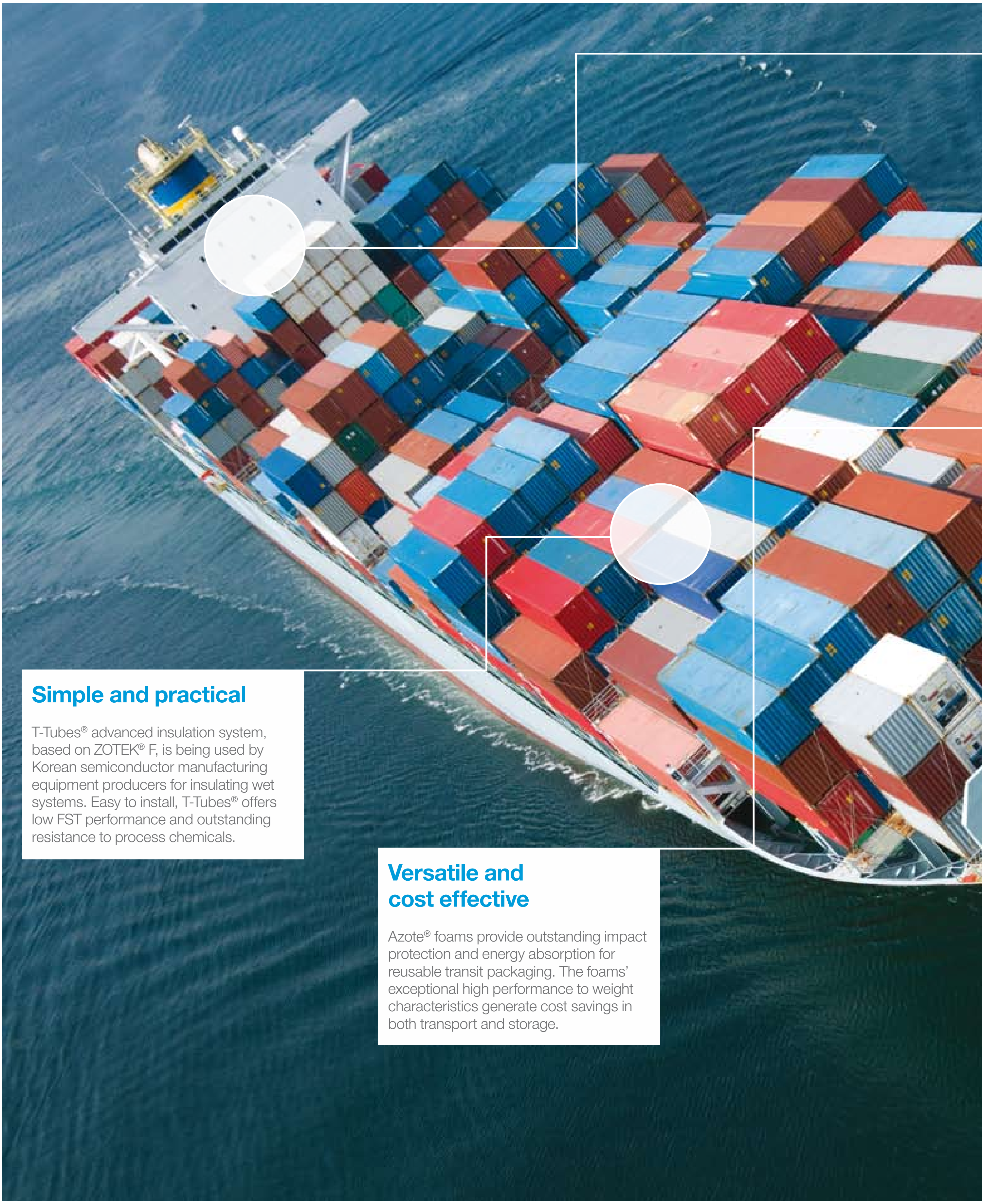
**A:** MEL licenses technology for foaming using extrusion systems. Zotefoams owns 30% of the Company and has the option of purchasing the remaining 70%, a decision which we will make in the second quarter of 2011. MEL’s technology is significant because it capitalises on the global trends towards a reduction of polymer content (and therefore costs) and the use of environmentally friendly gases as the foaming agent. Zotefoams is one of a number of licensees of this technology, which spans foam sheet and film as well as tubes, rods and other extruded plastic parts and profiles. This is an early stage business with the technology being developed across a wide variety of processes, some of which are significant users of polymer. We believe that MEL offers attractive growth potential.

### Q: Why should I invest in Zotefoams?

**A:** Zotefoams has consistently invested in production capacity, marketing resource and product research and development. We have regularly paid our shareholders dividends while ensuring the business has a multitude of growth options for the future. I am pleased to say that we have done this while increasing our cash resources and now feel we have a well-invested business capable of capitalising on global opportunities.

## Our strategy of investing in new unique products further differentiates us.

# Delivering value in Asia



## Simple and practical

T-Tubes® advanced insulation system, based on ZOTEK® F, is being used by Korean semiconductor manufacturing equipment producers for insulating wet systems. Easy to install, T-Tubes® offers low FST performance and outstanding resistance to process chemicals.

## Versatile and cost effective

Azote® foams provide outstanding impact protection and energy absorption for reusable transit packaging. The foams' exceptional high performance to weight characteristics generate cost savings in both transport and storage.

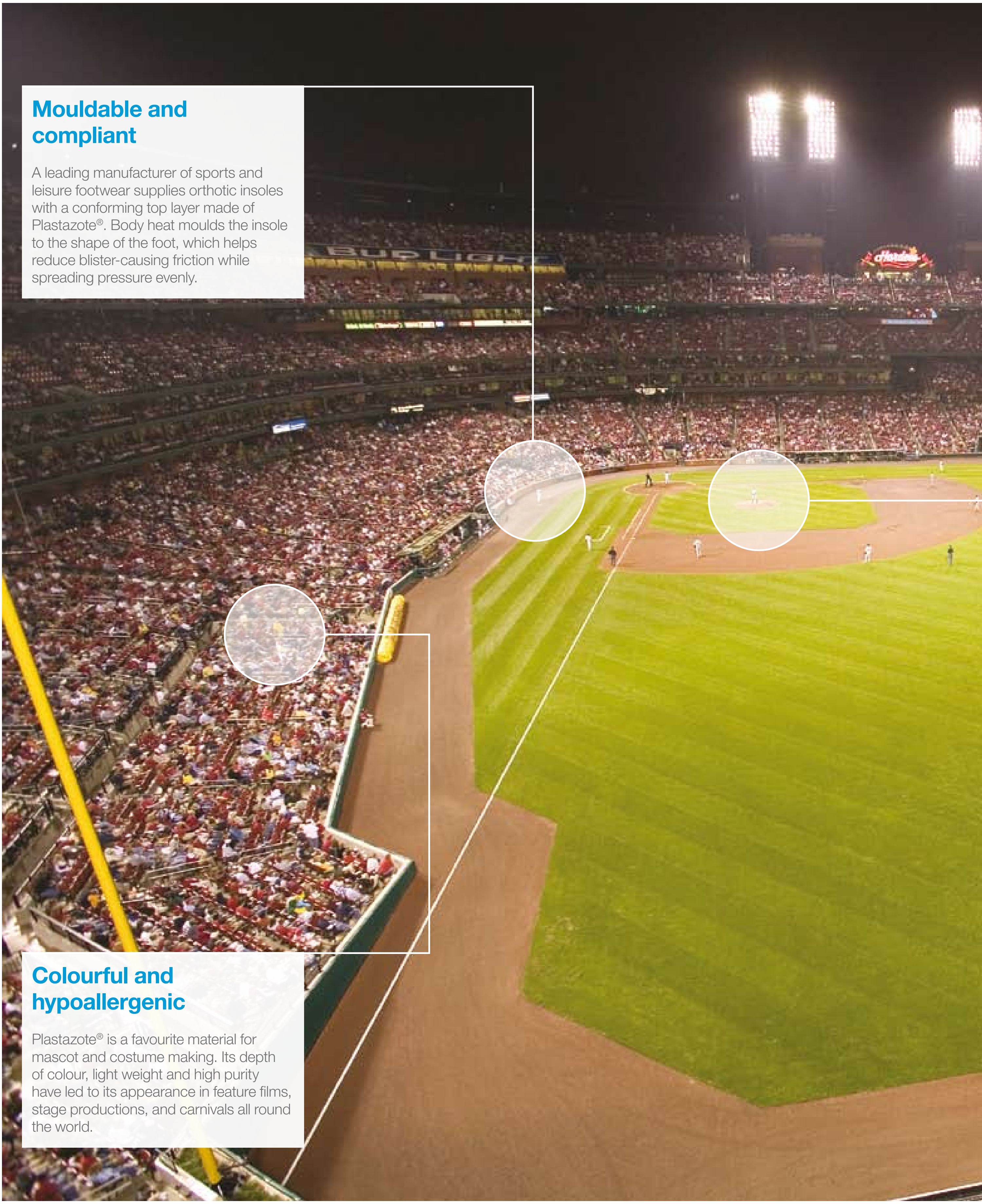
## Protecting sensitive products

As the world relies increasingly on electronics for everything from navigation to home computing, Zotefoams supplies high purity conductive and static dissipative Azote® materials that protect both fragile silicon wafers and electronic circuit components.

## Buoyancy, safety and comfort

Being closed cell and having exceptionally high strength to weight ratios, Azote® foams are the ideal materials to provide puncture resistant buoyancy for many marine applications such as life preservers, buoys, fenders, boat mats and floatable cushions.

# Out of the ballpark

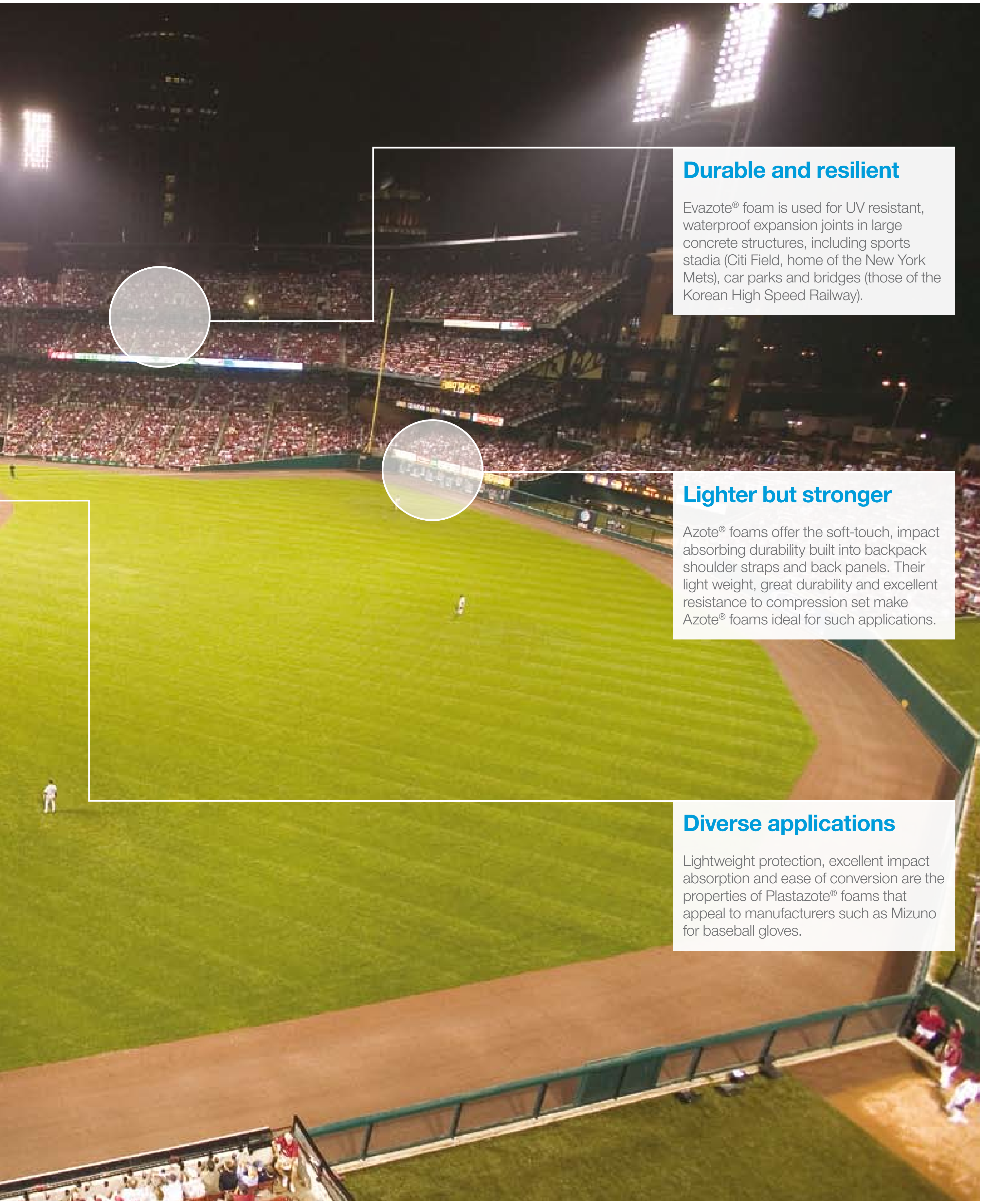


## Mouldable and compliant

A leading manufacturer of sports and leisure footwear supplies orthotic insoles with a conforming top layer made of Plastazote®. Body heat moulds the insole to the shape of the foot, which helps reduce blister-causing friction while spreading pressure evenly.

## Colourful and hypoallergenic

Plastazote® is a favourite material for mascot and costume making. Its depth of colour, light weight and high purity have led to its appearance in feature films, stage productions, and carnivals all round the world.



## Durable and resilient

Evazote® foam is used for UV resistant, waterproof expansion joints in large concrete structures, including sports stadia (Citi Field, home of the New York Mets), car parks and bridges (those of the Korean High Speed Railway).

## Lighter but stronger

Azote® foams offer the soft-touch, impact absorbing durability built into backpack shoulder straps and back panels. Their light weight, great durability and excellent resistance to compression set make Azote® foams ideal for such applications.

## Diverse applications

Lightweight protection, excellent impact absorption and ease of conversion are the properties of Plastazote® foams that appeal to manufacturers such as Mizuno for baseball gloves.

# Chairman's Statement
## Nigel Howard

**We are committed both to growing our core polyolefin business and developing a portfolio of unique foam products from high-performance materials.**

### Strategy
Zotefoams' strategy is to expand through a combination of profitable organic growth of both our Polyolefin and High-Performance Polymers ('HPP') businesses and through partnerships or acquisitions in related technologies, products or markets.

### Objectives
We intend sales growth in our core polyolefin business to exceed twice the average rate of increase in GDP. As our markets become more international, business originated in one country often leads to sales in other areas. Zotefoams is a global organisation with sales in America being supported by our factory in Kentucky, USA, which opened in mid-2001. In Asia we continue to consider a similar operation, either directly or as a joint venture, as sales increase to a level where such an investment becomes financially attractive.

We are also committed to developing a portfolio of unique foam products from high-performance materials with significant competitive advantages over rival materials. This will allow us to command higher margins and affirm our position as a leading foam technology company.

We intend to achieve this growth while continuing to improve our operating margins and our return on capital employed.

### Board
Our Board composition provides a balance of experience and independence, all aligned to our business needs and objectives. Sadly, at the end of November 2010, we were informed of the death of David Campbell who had served as a non-executive Director since 2007. David always made a valuable contribution to the deliberations of the Board and will be sadly missed as a colleague and a friend. We are currently recruiting two new independent non-executive Directors to replace David and in advance of Roger Lawson's anticipated retirement later in 2011 when he will have completed a nine-year term.

# We enter 2011 with a robust cash position and a wide variety of options for future growth.

### Employees
Our business relies on the skills and dedication of our employees and on behalf of the Board I would like to thank all of our employees whose contribution to the business made 2010 a successful year.

### Results
I am pleased to report our 2010 profit before tax and exceptional items increased by 49% to £4.70m (2009: £3.16m). Cash generated from operations was £7.23m (2009: £7.04m) and we finished the year with net funds of £1.86m (2009: net debt of £0.43m). International Accounting Standards require that from 1 July 2010 our 30% stake in MuCell Extrusion LLC ('MEL') was reported as a fully consolidated entity (prior to this MEL was treated as an associate entity) and the change in accounting treatment required by IFRS3 (revised) generated an exceptional profit of £1.10m. This exceptional item is a non-cash and non-taxable accounting entry. In 2009 exceptional costs of £0.41m were incurred primarily relating to the restructuring programme undertaken in Zotefoams in the first half of that year. Like for like sales (excluding MEL) increased by 23% to £39.27m (2009: £31.82m) as Azote® polyolefin sales volumes recovered in all major territories and our HPP segment turnover increased by 51% to £2.49m (2009: £1.64m). Consolidated sales, including six months sales of MEL, were £39.88m (2009: £31.82m).

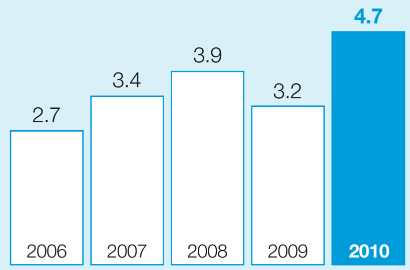
Profit before tax after exceptional items totalled £5.80m (2009: £2.75m).

### Dividend
As our profits and dividend cover have significantly increased the Board now intends to adopt a progressive dividend policy subject to profit growth, investment requirements and the other needs of the business. The Board therefore proposes a 5% increase in its final dividend to 3.15p per ordinary share (2009: 3.00p) which would make a total of 4.65p per ordinary share for the year (2009: 4.50p). At this level the dividend would be more than covered by two times post-tax earnings excluding exceptional items. If approved, the dividend will be paid on 24 May 2011 to shareholders on the register on 26 April 2011.

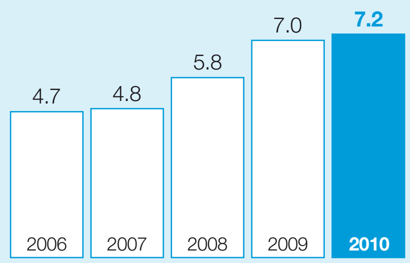
### Outlook
So far in 2011 we have seen very strong levels of order intake. High levels of market demand for polymer products are leading to rising raw material prices and certain supply related issues, requiring us to adopt more flexible production schedules and utilise alternative sources of supply. In the opening months of 2011 we have received our first sales order for our microZOTE® roll foam line and made our first sale of Pebaxfoam®, a high energy-return elastomer developed and launched in 2010 for the sports and leisure market. Exchange rates for the first two months of the year have been at similar levels to our 2010 average. Zotefoams operates in global markets across a wide variety of industries and we have a wide-ranging development programme for new products and new geographical markets. We are therefore influenced by the global economic situation and the timing of sales from new products and markets is more uncertain than in the more established businesses. We enter 2011 with a robust cash position, a wide variety of options for future growth and the Board is therefore confident about the long-term prospects for our business.

**Nigel Howard**
Chairman
7 March 2011

**Profit before tax**
(excluding exceptional items)
(£m)




**Cash generated from operations**
(£m)



# Business Review
## Clifford Hurst and David Stirling

**Clifford Hurst**
Finance Director

**David Stirling**
Managing Director

**Our sales growth is a direct result of investing in our Azote® polyolefin business while developing unique foams for high-performance applications.**

# Zotefoams is the world's leading manufacturer of cross-linked block foams.

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

## Business overview

2010 was a year of recovery and continued transition for Zotefoams as sales increased by 25% to £39.88m (2009: £31.82m). Sales of Azote® polyolefin foams increased by 22% from the low levels experienced in 2009. Importantly, the recovery was broadly spread across all of our major geographic sales regions. Turnover growth of 79% in Asia was particularly pleasing given our recent strategic investment and focus in this region. Our High-Performance Polymer ('HPP') foam sales grew by 51% and now represent 6.3% of Group foam sales excluding MEL. Turnover from MuCell Extrusion LLC ('MEL'), whose primary business is the licensing of technology for foaming using extrusion processes, was £0.61m for the six months from 1 July 2010. This represents 1.5% of Group sales in the year. Our sales growth is a direct result of Zotefoams' strategy of investing in our Azote® business while developing unique foams for high-performance applications.

Our Azote® block foams are manufactured using a unique production process which uses nitrogen gas at high temperature and pressure to foam solid plastics. Azote® polyolefin foams are used in a wide variety of applications where their consistency, purity, performance at light weight and durability are valued across the world. Typically, our products are sold to foam converters who process the foam by a variety of techniques such as cutting, welding, moulding and routing into finished or semi-finished parts based on end-user requirements.

Zotefoams uses this same unique technology to process high-performance polymers into our HPP block foams. In 2010 we developed foam made from Pebax® polyether block amide copolymer. This was launched late in 2010 as the fourth major HPP foam range alongside our ZOTEK® fluoropolymer and nylon block foams and our microZOTE® closed-cell roll foams. Pebaxfoam® builds on Arkema's strong Pebax® trademark and is being promoted jointly by Zotefoams and Arkema into a variety of applications with a particular focus on the sports market where the high energy-return properties are of particular interest. Our HPP block foams are targeted at highly technical and demanding applications, often in markets such as aerospace, pharmaceutical, semi-conductor, chemical processing and automotive where market development lead times are long. The timing of revenue generation from these types of development is therefore inherently difficult to predict. Our microZOTE® products, made using the patented MuCell® $CO_2$ foaming process, are currently focused on roll foam polyolefins and offer customers pure and environmentally friendly foam in thin roll format. We increased expenditure on research and development, primarily related to our HPP segment, by 13% to £875,000 (2009: £776,000) reflecting the scale of the opportunities we see in the future of this business.

Turnover in our Azote® polyolefin business grew 22% to £36.78m (2009: £30.17m). Overall sales volumes increased by 26% offset by a 2% adverse currency movement and a slight change in product mix. Recovery from 2009 was strongest in geographies with a higher concentration of industrial applications, such as Germany and northern Europe. Turnover in UK and North America increased by 18% and 17% respectively while sales in France, where our consumer-focused end use insulated us from the worst effects of recession in 2009, were relatively flat. Sales in Asia increased by 57% compared to 2009 and now represent approximately 6% of global Azote® turnover. The average price of our major raw material LDPE (low density polyethylene) increased by 33% to €1,250 per tonne. Operating margins in our Azote® polyolefin business increased to 14.4% (2009: 13.0%) as a result of increased sales volumes and tight cost controls exceeding input price increases.

HPP sales grew by 51% in 2010 to £2.49m (2009: £1.64 m). T-Tubes® high-performance insulation, made from ZOTEK® F fluoropolymer foam, was the fastest growing product line in the period and accounted for approximately one quarter of all HPP sales in 2010. Our ZOTEK® F fluoropolymer foams continue to find new applications in aviation and aerospace and, in particular a large project with the European Space Agency for packaging materials for the international space station was completed in 2010. The majority of ZOTEK® F sales are in aviation, currently primarily in North America and this is progressing well although delays in the launch of some customer programs will slow growth in this market during 2011. During 2010 we made good progress improving manufacturing reliability of our ZOTEK® N nylon foams. The development pipeline for nylon foam is now showing its promise with the number of current commercial applications being small relative to the potential under evaluation. To meet existing demand and support this development pipeline we are currently building inventories of two commercially launched products in this range, both of which exhibit excellent temperature resistance. Therefore, despite the delays experienced to date, we continue to believe in the transformational potential of the nylon product line.

The costs of development of our microZOTE® closed-cell roll foams, including depreciation, are recorded within our HPP business segment. The first commercial products, recyclable closed-cell polyethylene foams, were launched late in 2010 and, following customer trials, we recently received our first sales order.

Group capital expenditure was substantially related to our Azote® business with a new low-pressure expansion vessel delivered in late 2010 for commissioning in mid-2011 being the largest single project. Other capital expenditure was focused on plant reliability, efficiency and 'de-bottlenecking' with investment in electrical infrastructure and high-pressure compressor capacity and associated systems. In addition, we completed the upgrade of our extrusion system for nylon, having traced some problems in the development of nylon foams caused by this machinery. Overall we invested £2.67m (2009: £3.43m) which is slightly below depreciation of £3.11m due to the timing of expenditure on large projects.

MEL is involved in the development and licensing of technology for microcellular foam extrusion of sheet and profiles using carbon dioxide or nitrogen. Many MEL licensees are interested in relatively small reductions in polymer content, creating 'foams' with microcellular bubbles reducing weight in the order of 10-30%, simply to reduce costs. Other licensees are interested in creating fully recyclable, light-density foams using

# **Business Review** continued
## David Stirling and Clifford Hurst

environmentally friendly, naturally occurring gases. Often available as a retrofit to existing process machinery, MEL's technology is perfectly aligned to meet the global trends of reducing polymer content in response to increasing commodity prices and environmental responsibility. The anniversary dates when most of the revenue is generated of the current licence portfolio fall mainly in the first six months of the year and turnover for the second half of the year, fully consolidated into Zotefoams' results for the first time was £0.61m. Zotefoams owns 30% of MEL and holds an option, exercisable by 30 June 2011, to acquire the remaining balance of 70% of the shareholding units in MEL.

### Strategy and objectives

Zotefoams' strategy is to grow its existing business in polyolefin foams while developing a portfolio of high-performance polymers. In 2010 aided by the recovery in economic conditions, we made very solid progress on all of our stated objectives. Our Azote® business delivered a record sales year as did our HPP business. We finished the year with positive cash while investing in the development of a wider portfolio of new products and in capacity and efficiency improvements primarily in our Croydon plant.

**Our stated objectives are to:**

1. Grow sales in our polyolefin business:
   a) In excess of the rate of inflation in Europe
   b) To achieve double digit percentage growth in North America
   c) To achieve double digit percentage growth in Asia.
2. Develop a HPP portfolio to deliver enhanced margins.
3. Improve our operating margins.
4. Improve our return on capital employed.

**Performance against these objectives was as follows:**

1. Sales
   a) Turnover from our Azote® polyolefin foams increased by 24% in the UK and Europe in constant currency;
   b) In North America polyolefin sales increased by 16% in constant currency; and
   c) Polyolefin foams sales in Asia grew by 57% and this region now accounts for 6.1% of global Azote® revenues.
2. HPP sales grew by 51% and now represent 6.3% of Group foam sales excluding MEL. The operating loss on this segment before depreciation was £0.19m (2009: £0.41m) as we continue to invest in R&D and marketing products which in 2010 were not yet revenue generating such as microZOTE®, Pebaxfoam® and other development projects at pre-production stage. Sales of ZOTEK® F and T-Tubes® are profitable.
3. Group operating margins, excluding exceptional items and MEL, increased to 12.4% (2009: 10.7%) our highest level in recent years.
4. Pre-tax return on average capital employed, excluding exceptional items and MEL, increased from 11.5% to 16.9%.

From 2011, we intend to focus on the same four key objectives in our business. However, as the Azote® polyolefin business becomes more global, with sales development in one region leading to sales in another and customer manufacturing locations more likely to relocate between regions, we will adopt a single measure across this business. From 2011 our initial objective will be 'Sales growth in our polyolefin business to exceed twice the average rate of GDP growth'.

### Financial results

Zotefoams owns a 30% interest in MEL with an option to increase its holding to 100%. This option is exercisable from 1 July 2010 to 30 June 2011. Under IFRS3 (revised), Zotefoams is therefore deemed to have a controlling interest in MEL from 1 July 2010 requiring a deemed disposal of Zotefoams' associate interest at 1 July 2010 and MEL to be consolidated in Zotefoams' consolidated group accounts from that date even though Zotefoams has not exercised the option. If Zotefoams do not acquire a controlling interest in MEL by 30 June 2011, the date the purchase option lapses, then from this date MEL will no longer be consolidated in Zotefoams' group accounts. In these circumstances, from 1 July 2011, Zotefoams would treat its 30% holding as an associate interest.

The required accounting treatment in Zotefoams' consolidated income statement has created a deemed disposal of this associate interest on 1 July 2010 disclosed as an exceptional item and the consolidation of MEL as a subsidiary company for the six months ended 31 December 2010. The exceptional profit created on the deemed disposal of Zotefoams' associate interest in MEL is £1.10m. £0.65m of this is due to the uplift in the fair value of MEL. At 1 July 2010 the fair value of MEL has been reassessed at $12.38m, which is the sum of the $3.00m Zotefoams paid in 2008 for its original 30% share and $9.38m which is the option price for the remaining 70% share to take full ownership. The remaining £0.45m exceptional profit is the exchange movement on the original $3.00m investment which until 30 June 2010 has been taken to the Statement of Comprehensive Income rather than the Income Statement. On the deemed disposal of the associate interest this exchange movement is now taken out of reserves to the Income Statement as an exceptional item. It is recognised as a profit as the original investment made in MEL was in 2008 when the exchange rate was $/£2.00 and the exchange rate at 1 July 2010 was $/£1.51.

Group turnover increased by 25% from £31.82m to £39.88m in 2010. Excluding MEL and exceptional items, gross margin fell from 31% in 2009 to 29% in 2010. Raw material price rises and an unfavourable currency impact of approximately 1% were partially offset by the operational gearing benefit of the additional sales volumes and efficiency improvements. The average price of low density polyethylene, our largest raw material, increased by 33%: from €940 per tonne in 2009 to €1,250 per tonne in 2010. Underlying distribution costs and administrative expenses excluding MEL, foreign exchange gains and losses and exceptional items, increased by 15% to support the sales growth and investment in HPP.

Profit before tax and exceptional items increased by 49% from £3.16m to £4.70m. The inclusion of MEL as a subsidiary in the second half of the year has a minimal effect on profit. Due to the timing of revenue recognised on its current licence agreements MEL makes most of its profit in the first half of the calendar year. Profit before tax after exceptional items totalled £5.80m (2009: £2.75m).

The effective tax charge, pre-exceptional items is 21%, (2009: 22%) which is lower than the UK corporation tax rate of 28%. This is principally due to the lower tax charges incurred in our USA operations where we have brought forward tax losses and UK research and development tax credits. The cash impact of the tax charge is higher at 24% (2009: 27%) because of a deferred tax credit of £0.15m (2009: £0.15m) reflecting the difference in timing between tax allowances and accounting charges.

**Earnings per share and dividend**
Group earnings per share were 10.2p (2009: 6.8p) before and 13.1p (2009: 5.9p) after exceptional items. The Directors are recommending an increased final dividend of 3.15p per share, and, subject to shareholder approval, payable on 24 May 2011 to shareholders on the Company register at 26 April 2011. This would bring the total dividend to 4.65p per ordinary share for the year (2009: 4.50p).

**Cash flow**
Earnings before interest, tax, depreciation and amortisation (EBITDA) before exceptional items were £8.09m (2009: £7.00m) reflecting the higher operating profit. Cash generated from operations was £7.23m (2009: £7.04m) after payments to the pension fund of £0.66m and an increase in working capital of £0.38m. This funded capital expenditure of £2.67m (2009: £3.43m). After tax payments of £0.99m and the payment of dividends of £1.65m the Group was left with net funds of £1.86m (2009: net debt of £0.43m). This includes £0.36m for the cash held by MEL which was not consolidated in 2009.

**Balance sheet**
The Consolidated Statement of Financial Position includes MEL's net assets of £7.68m. This is principally comprised of intangible assets and goodwill of £7.17m and cash balances of £0.36m. In Consolidated Equity, within this statement, a non-controlling interest of £5.38m is shown which represents the 70% share of MEL which Zotefoams does not own.

**Pensions**
The gross IAS19 deficit on the Company's Defined Benefit Pension Scheme (the 'Scheme') decreased by £0.82m from £5.78m to £4.96m. The reduction was due to higher than expected return on assets, the contributions paid into the Scheme and lower assumptions for inflationary increases. This was partly offset by a lower discount rate assumption. Company contributions to the Scheme in 2010 were £0.66m as agreed by the Company and the Trustees following the 2008 triennial review to reduce the deficit. This will be reviewed after the next triennial actuarial valuation of the pension fund which will be calculated on the fund's position in April 2011. The Company closed the Scheme to future accrual of benefit in 2005. The Company has entered into discussion with the Scheme Trustees on changes in

## In-flight Comfort and Protection

**In collaboration with Zotefoams, MGR Foamex has developed MGRSoftWall™, a new soft trim aircraft panel system based on ZOTEK® F that is both weight-saving and meets the latest aviation flammability requirements.**

# **Business Review** continued
## David Stirling and Clifford Hurst

**Lighter and brighter**

**To improve the brightness of LED lighting, illuminated signage and flat panel displays, Dueller, an innovative Japanese manufacturer, has developed Diffure, a light reflective acrylic polymer material, formed using the MuCell® Extrusion Process.**

government guidance on inflation measures from RPI to CPI. These discussions are still underway and the Company has therefore left the inflation measures unchanged for these financial statements.

### Risks and uncertainties

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

**Operational disruption**

Zotefoams' business is dependent on the ongoing operation of manufacturing facilities. Any significant operational disruption could impact our ability to manufacture and supply products. The Directors consider the Company's extensive Safety, Health and Environment ('SHE') policies and procedures to be the main mitigating controls around these risks. These are described in more detail in the Corporate Social Responsibility Report on page 31. The Group also holds insurance which is designed to cover capital reinstatement and loss of profits in the event of operational disruption caused by certain events. We use pressure equipment which is operated under the Pressure Systems Safety Regulations 2000 and SAFed ('best practice' system) which requires systematic internal and frequent external inspections.

**Supply chain disruption**
Certain raw materials are currently only available from single sources. Inability to source these materials may result in an inability to supply products to our customers. Zotefoams seeks wherever practical to purchase materials from more than one source but the highly specified nature of our product lines means this is not always possible. We therefore monitor the situation closely and maintain 'desk-top' studies of alternative materials which may be offered to our customers as substitutes. Currently high levels of demand for polymer products and changes in availability of supply from some suppliers is requiring us to adopt more flexible production schedules and utilise some of these alternative sources of supply.

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

**Pension liabilities**
Zotefoams operates a Defined Benefit Pension Scheme with retirement benefits being based on final salary. The value of scheme liabilities and assets, along with the assumptions used in this valuation, are disclosed in note 23 of the financial statements. Any change in the assumptions used or where the actual outcome varies from these assumptions may have a significant effect on the liabilities or assets which, ultimately, may be the responsibility of the Company. We have taken steps to minimise the risk to the Company by closing the Scheme to new members in 2001 and closing it to future accrual of benefits in 2005. In April 2008, the triennial actuarial review valued the Scheme deficit at £3.33m, an increase of £0.79m from the previous triennial review in April 2005. As a result of this review the Company agreed with the Trustees to pay £55,000 per month into the Scheme from January 2009 until June 2016 to eliminate this deficit, based on the actuarial assumptions made in April 2008. This will be reviewed after the next triennial actuarial valuation of the pension fund which will be calculated on the fund's position in April 2011.

**Foreign exchange**
Zotefoams mainly sells in the local currencies of the customer and in 2010 approximately 80% of our revenue was in currencies other than sterling, particularly euros and US dollars. Our manufacturing assets and costs, including capital expenditure, are substantially in the UK and therefore sterling denominated, although we do have US dollar costs associated with our facility in Kentucky, USA and the majority of our raw material purchases are denominated in euros. The net impact of this is that we generate surpluses in euros and US dollars which we convert to sterling. We manage this risk firstly by converting all purchases to either euros or US dollars wherever sensible. This reduces our net exposure and transaction costs of converting from one currency to another. The Group hedging policy to deal with the remaining risk is set out in note 21 of the financial statements.

**Financing**
The Company finances its activities partly through the use of bank overdraft and loan facilities, the utilisation of which fluctuates during the year. The Company has a £4.90m overdraft facility which is repayable on demand and a £3.30m loan. This loan is repayable over five years, has no operating covenants and is secured against certain items of plant and equipment. At 31 December 2010 £1.15m of this loan had been repaid. We finished the year with net funds at 31 December 2010 of £1.86m (2009: net debt of £0.43m) of which £0.36m is cash balances held by MEL.

**David Stirling**
Managing Director

**Clifford Hurst**
Finance Director

7 March 2011

# Directors and Advisers

### Nigel Howard BSC ARCS*#

**Non-executive Chairman and Chairman of the Nominations Committee**

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

### David Stirling BSC CA MBA MSC

**Managing Director**

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

### Clifford Hurst BA FCA MCT

**Finance Director and Company Secretary**

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

### Roger Lawson FCA*†#

**Senior independent non-executive Director and Chairman of the Audit Committee**

Appointed to the Board in December 2002. Previously a Director of 3i plc and a former President of the Institute of Chartered Accountants in England and Wales. He is a non-executive Director of a number of unlisted companies and a Trustee of the Thalidomide Trust.

### Richard Clowes BSC C.ENG, M.I.MECH.E *†#

**Non-executive Director**

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

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





Nigel Howard
David Stirling
Clifford Hurst
Roger Lawson
Richard Clowes

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**Registered Number**
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Crawley RH11 9PT

**Bankers**
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London E14 5HP

**Solicitors**
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One London Wall
London EC2Y 5EB

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**Registrars**
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**Corporate Brokers**
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# Directors' Report

The Directors present their annual report and audited financial statements for the year ended 31 December 2010.

### Principal activity

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

### Business review

The Company is required by the Companies Act to set out in this report a fair review of the business of the Group during the financial year ended 31 December 2010 and of the position of the Group at the end of the year and a description of the principal risks and uncertainties facing the Group. The information that fulfils this requirement can be found within the Business Review on pages 14 to 19.

### Results and dividends

Profit attributable to shareholders for the year amounted to £4.83m (2009: £2.16m). An interim dividend of 1.50p (2009: 1.50p) per share was paid on 14 October 2010. The Directors recommend that a final dividend of 3.15p (2009: 3.00p) per share be paid on 24 May 2011 to shareholders who are on the Company's register at the close of business on 26 April 2011. This makes a total dividend of 4.65p per share for the year (2009: 4.50p).

### Directors

The appointment, replacement and powers of Directors are governed by the Company's Articles of Association, the Combined Code, the Companies Act, prevailing legislation and resolutions passed at the Annual General Meeting ('AGM') or other general meeting of the Company.

All of the current Directors named on pages 20 to 21 served throughout the year. In addition D A Campbell served as a Director from the start of the year until his death on 29 November 2010. The Directors retiring by rotation at the AGM are R J Clowes and R H Lawson who, being eligible, offer themselves for re-election. Both have service contracts with the Company which are terminable on six months written notice. Biographical details of R J Clowes and R H Lawson can be found in the section on Directors and Advisers on pages 20 to 21.

The Company has granted indemnities in favour of Directors under Deeds of Indemnity. These Deeds were in force during the year ended 31 December 2010 and remain in force as at the date of this report. The Deeds and the Company's Articles of Association are available for inspection during normal business hours at the Company's registered office and will be available at the AGM.

### Employees

To ensure employee welfare, the Group has documented and well-publicised policies on occupational health and safety, the environment and training. It operates an equal opportunities, single status employment policy, together with an open management style. The Company operates to a number of recognised industry standards including Quality (ISO 9001), Environmental (ISO 14001) and Occupational Health and Safety (OHSAS 18001) approvals.

Further details of the Group's employment policies, including its policy regarding the employment of disabled people are set out in the Corporate Social Responsibility Report on page 31.

### Substantial shareholdings

As at 7 March 2011, the Company had received notice of the following material interests of 3% or more in the issued ordinary share capital:

| | Ordinary share of 5.0p | Percentage of issued share capital |
|---|---|---|
| BlackRock Inc. | 5,365,824 | 14.01% |
| Schroder Investment Management | 4,591.612 | 11.99% |
| Gartmore Investment Limited | 4,148,024 | 10.83% |
| Sekisui Alveo AG | 3,814,762 | 9.96% |
| Aberdeen Asset Management PLC's Fund Management Subsidiaries | 1,452,000 | 3.79% |
| Nicholas Adrian Beaumont-Dark | 1,185,000 | 3.09% |

The holding held by BlackRock Inc. includes notified holdings on behalf of BlackRock Emerging Companies Hedge Fund (2,740,941 shares, 7.16%) and BlackRock UK Smaller Companies Fund (1,919,285 shares, 5.01%)

Directors' shareholdings are shown in the Directors' Remuneration Report.

### Research and development

The amount spent by the Group on R&D in the year was £875,000 (2009: £776,000). This included work on nylon and microZOTE® as well as potential longer-term products in the development pipeline. In the opinion of the Directors none of this expenditure met the requirements for capitalisation in IAS38 and it was consequently all expensed in the Consolidated Income Statement.

### Creditor payment policy

It is not Group policy to follow any standard or code of payment practice. Payment terms are agreed with suppliers when negotiating contracts or transactions. The Group aims to ensure that subject to any necessary variations which may result from supplier-related problems, the agreed payment terms are adhered to. At 31 December 2010, trade creditors of the Company represented 27 days of purchases (2009: 30 days).

**Share capital and reserves**
The Company has one class of ordinary shares which carry no right to fixed income. Each share carries the right to one vote at general meetings of the Company. There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights. No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

At 31 December 2010 the Zotefoams Employee Benefit Trust (EBT) held 1,389,861 shares (2009: 1,891,147 shares) to satisfy share plans as described in the Directors' Remuneration Report. During the year it issued 786,698 shares in respect of these share plans and bought 285,412 shares at an average price of 117p to satisfy future share awards.

At the AGM held on 11 May 2010 the Company was given authority to purchase up to 3,829,709 of its ordinary shares. This authority will expire at the 2011 AGM. During the period from 11 May 2010 until the date of this Report this authority was not used but in accordance with normal practice for listed companies a special resolution will be proposed at this year's AGM to renew the authority to make market purchases up to a maximum of 10% of the issued share capital of the Company.

**Treasury and financial instruments**
Information in respect of the Group's policies on financial risk management objectives, including policies for hedging, as well as an indication of exposure to financial risk is given on page 48 and in note 21 to the financial statements.

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

**Charitable and political donations**
The Group made charitable contributions of £800 (2009: nil) and no political contributions (2009: nil) in the year.

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

**Going concern**
The Directors consider the use of the going concern basis of accounting is appropriate because they have identified no material uncertainties related to events or conditions that may cast significant doubt about the ability of the Group to continue as a going concern. See the Corporate Governance report, page 33.

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

By order of the Board

**C G Hurst**
Company Secretary
7 March 2011

# Directors' Remuneration Report

This report has been prepared in accordance with the Companies Act 2006. The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the principles relating to Directors' remuneration. As required by the Act, a resolution to approve this report will be proposed at the AGM of the Company at which the approval of the financial statements will be proposed.

The Act requires the auditor to report to the Company's members on certain parts of the Directors' Remuneration Report and to state whether in their opinion those parts of the report have been properly prepared in accordance with the Companies Act 2006. The report has therefore been divided into separate sections for audited and unaudited information.

## Information not subject to audit

### Remuneration Committee

The Company has established a Remuneration Committee which is constituted in accordance with the recommendations of the Combined Code. R J Clowes, N G Howard and R H Lawson were members of this Committee throughout 2010 to the date of this report. In addition D A Campbell was a member of the Committee until his death on 29 November 2010. All the members are independent non-executive Directors apart from N G Howard, who was independent on appointment as Chairman of the Company. The Committee was chaired throughout 2010 to 29 November 2010 by D A Campbell and thereafter by R J Clowes.

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

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

### Remuneration policy for the Executive Directors

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

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

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

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

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

### Basic annual salary

An Executive Director's basic annual salary is reviewed by the Committee at the beginning of each year and when an individual changes position or responsibility. In deciding appropriate levels the Committee considers the Executive Team as a whole, individual performance and independent surveys of Directors' remuneration. The Committee's policy is to set basic annual salaries at a level below what it believes is the average market rate for the individual concerned while setting the incentive potential at a consequently higher rate. Following a review of benchmark information for similar roles prepared by independent remuneration consultants, MM&K Limited, the Remuneration Committee increased salaries on 1 April 2010. Basic annual salaries have not been increased since 1 April 2010.

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

### Benefits

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

### Annual bonus payments

The Committee's normal policy on bonuses is that it establishes the objectives that must be met for each financial year if a bonus is to be paid. In setting appropriate bonus levels the Committee refers to independent surveys of Directors' remuneration. The Committee believes that any incentive compensation awarded should be tied to the interests of the Company's shareholders and that the principal measure of those interests is profit before taxation excluding exceptional items. The bonus award is normally capped at 100% of bonusable salary. That element of the bonus payment over 40% of bonusable salary is paid in restricted shares which will normally only be capable of release if the executive is still employed by the Company three years later.

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

The main long-term incentive scheme operated by the Company is the Long-Term Incentive Plan (LTIP) award to the Executive Directors and senior management. The LTIP awards are subject to performance conditions on Total Shareholder Return and EPS (excluding exceptional items) over a three year period. These performance criteria, which applied to all Executive Directors to whom options have been granted under the Scheme, were chosen because the Committee believed it best aligned this incentive with shareholder interests. In 2010 an award of 50% of salary was made.

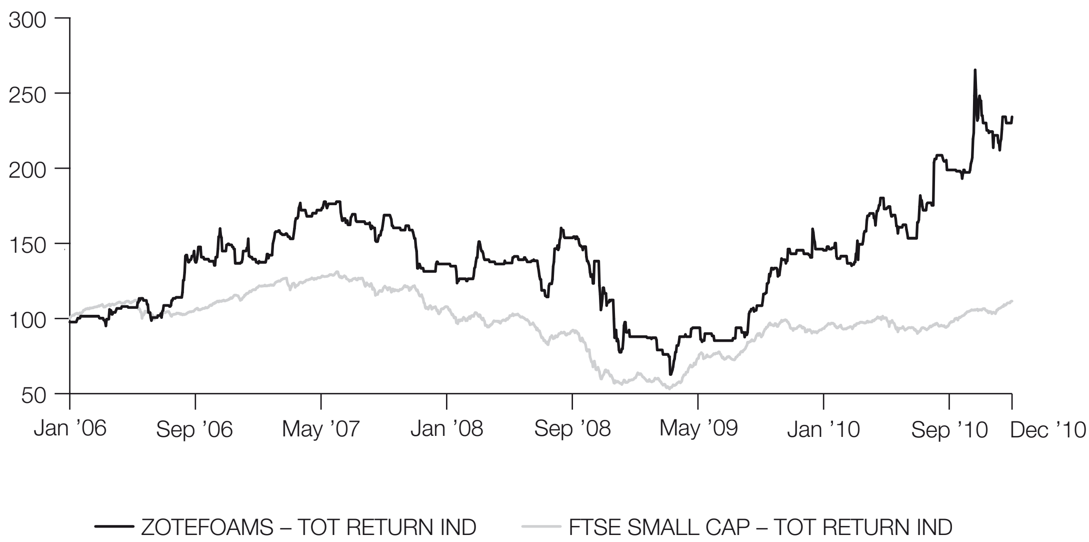
UK based Executive Directors and senior management have also been granted share options under a Her Majesty's Revenue and Customs Approved Share Option Scheme. These options are not exercisable unless the Group's normalised earnings per share, excluding exceptional items, increases by at least three percentage points per annum in excess of the increase in the Retail Price Index over the same period. The exercise price of the options granted under the above schemes is equal to the market value of the Company's share price at the time when the options are granted. The Executive Directors are entitled to participate provided they meet the eligibility requirements of the scheme.

The Company also has an Executive Share Option Scheme. This was replaced as the main long-term incentive scheme in 2007 by the LTIP award. No awards have been made under the Executive Share Option Scheme in 2010.

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

**Performance graph**
The following graph charts the total cumulative shareholder return (share price movements plus dividends reinvested) of the Company since January 2006. It is compared to the FTSE Small Cap Index which the Board believes is the most relevant comparison for a company of Zotefoams' size.

Zotefoams and FTSE Small Cap Total Return Index ('TRI') re-based to 100 (January 2006 to December 2010).



# **Directors' Remuneration Report** continued

### Service contracts

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

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

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

### Non-executive Directors

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

## Information subject to audit

### Directors' emoluments

| Remuneration in £ | Basic salary/fees | Operational bonus | Car allowance | Company pension contributions[2] | Other benefits[1] | **Total 2010** | Total 2009 |
|---|---|---|---|---|---|---|---|
| D A Campbell[3] | 23,457 | — | — | — | — | **23,457** | 24,500 |
| R J Clowes | 23,627 | — | — | — | — | **23,627** | 22,500 |
| N G Howard | 48,873 | — | — | — | — | **48,873** | 47,000 |
| C G Hurst | 112,145 | 57,750 | 10,561 | 21,536 | 1,342 | **203,334** | 130,838 |
| R H Lawson | 25,624 | — | — | — | — | **25,624** | 24,500 |
| D B Stirling | 161,168 | 83,160 | 11,640 | 27,890 | 1,254 | **285,112** | 177,562 |
| | 394,894 | 140,910 | 22,201 | 49,426 | 2,596 | **610,027** | 426,900 |

1 Other benefits are calculated in terms of taxable values in the UK.

2 The Company operates a Defined Contribution ('DC') Pension Plan. Individuals can opt to change their contract of employment under a salary sacrifice arrangement, under which their salary is reduced and the Company makes a corresponding contribution into their DC Pension Plan. Both the Executive Directors have opted for the salary sacrifice scheme and the total contributions made by the Company to each individual's pension plan are shown above. None of the Executive Directors made any employee contributions to the DC Pension Plan.

3 D A Campbell's remuneration covers the period from 1 January 2010 to his death on 29 November 2010.

### Directors' shareholdings

The beneficial and non-beneficial interests of the Directors (including persons connected with them within the meaning of Section 252 of the Companies Act 2006) in the ordinary shares of the Company are set out below:

| Number of ordinary 5p shares | **31 December 2010** | 31 December 2009 |
|---|---|---|
| D A Campbell | **Not applicable** | 5,939 |
| R J Clowes | **45,000** | 35,000 |
| N G Howard | **60,000** | 60,000 |
| C G Hurst | **124,811** | 78,745 |
| R H Lawson | **5,000** | 5,000 |
| D B Stirling | **144,445** | 102,711 |
| | **379,256** | 287,395 |

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

**Share options**

Options over ordinary shares granted:

| | Scheme | As at 31 December 2009 | Granted | Exercised | Lapsed | Cancelled | **As at 31 December 2010** | Exercise price | Exercisable | Expiry date |
|---|---|---|---|---|---|---|---|---|---|---|
| C G Hurst | Executive SOS | 59,631 | — | — | — | — | **59,631** | 72.5p | 7.04.2007 | 6.04.2014 |
| C G Hurst | Executive SOS | 115,909 | — | — | — | — | **115,909** | 77.0p | 22.12.2008 | 21.12.2015 |
| D B Stirling | Executive SOS | 160,389 | — | (160,389) | — | — | **—** | 77.0p | 22.12.2008 | 21.12.2015 |
| C G Hurst | LTIP | 51,777 | — | — | (23,351) | — | **28,426** | nil | 20.03.2011 | n/a |
| D B Stirling | LTIP | 74,112 | — | — | (33,425) | — | **40,687** | nil | 20.03.2011 | n/a |
| C G Hurst | 2007 Deferred Bonus | 7,358 | — | — | — | — | **7,358** | nil | 20.03.2011 | n/a |
| D B Stirling | 2007 Deferred Bonus | 14,201 | — | — | — | — | **14,201** | nil | 20.03.2011 | n/a |
| C G Hurst | HMRC SOS | 28,116 | — | — | — | — | **28,116** | 106.7 | 12.08.2011 | 11.08.2018 |
| D B Stirling | HMRC SOS | 28,116 | — | — | — | — | **28,116** | 106.7 | 12.08.2011 | 11.08.2018 |
| C G Hurst | LTIP | 116,413 | — | — | — | — | **116,413** | nil | 16.03.2012 | n/a |
| D B Stirling | LTIP | 166,630 | — | — | — | — | **166,630** | nil | 16.03.2012 | n/a |
| C G Hurst | 2009 Share Bonus Plan | 46,263 | — | (46,263) | — | — | **—** | nil | 11.03.2010 | n/a |
| D B Stirling | 2009 Share Bonus Plan | 66,220 | — | (66,260) | — | — | **—** | nil | 11.03.2010 | n/a |
| C G Hurst | 2009 Deferred Bonus | 6,408 | — | — | — | — | **6,408** | nil | 11.03.2013 | n/a |
| D B Stirling | 2009 Deferred Bonus | 9,173 | — | — | — | — | **9,173** | nil | 11.03.2013 | n/a |
| C G Hurst | LTIP | — | 54,090 | — | — | — | **54,090** | nil | 19.03.2013 | n/a |
| D B Stirling | LTIP | — | 77,424 | — | — | — | **77,424** | nil | 19.03.2013 | n/a |

**Executive Share Option Scheme (Executive SOS)**

These options were granted under the Zotefoams Executive Share Option Scheme. This scheme was replaced by LTIP awards in 2007.

There were no options awarded under the Executive SOS in 2010 and there have been no changes in options granted between the end of the year and the date of this report.

The middle market quoted share price at 31 December 2010 was 142.5p and the high and low prices during the year were 161.5p and 85.5p respectively.

**Long-term Incentive Plans (LTIP)**

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

For the 2010 award these criteria are:

| | **Threshold** | | **Maximum** | |
|---|---|---|---|---|
| | **Performance Target** | **% of award vesting** | **Performance Target** | **% of award vesting** |
| TSR goal | 10% pa growth | 12.5 | 25% pa growth | 50 |
| EPS goal | 9.2p | 12.5 | 14.3p | 50 |

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

The market value of the 2010 LTIP shares granted was 99p on the date of the grant.

The LTIP awards made in March 2008 are subject to TSR and EPS thresholds for the year ended 31 December 2010. Based on the performance of the Company as at 31 December 2010, 54.9% of the shares will vest under this award.

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

These options have been granted under a HMRC Approved Share Option Scheme. These options are not exercisable unless EPS increases over a three year period by at least three percentage points pa in excess of the increase in the Retail Price Index over the same period. For the awards exercisable in August 2011 this criterion has been met and these awards will vest at their exercise date.

**Deferred bonus plan**

Bonus awards over 40% of salary are in restricted shares which will normally only be capable of release if the executive is still employed by the Company three years later. In 2010 the bonus award under the executive bonus scheme was 46.2% of which 40% will be paid in cash and 6.2% in deferred bonus shares. Profit before tax and exceptional items increased by 49% in 2010.

# **Directors' Remuneration Report** continued

**Directors' pension entitlements**
The Zotefoams Defined Benefit Pension Scheme was closed to future accrual of benefits from 31 December 2005. At this time, all active members left the Scheme and were granted preserved pensions payable from their normal retirement age (or immediately, if the member had reached normal retirement age).

The following serving Directors were members of the Zotefoams Pension Scheme during the year.

| | Accrued pension in scheme at year end[1] £ | Gross increase in pension £ | Increase in accrued pension net of RPI inflation £ | Value of accrued pension at year end[2] £ | Value of accrued pension at start of year[3] £ |
|---|---|---|---|---|---|
| C G Hurst | 8,633 | 417 | — | 90,116 | 81,040 |
| D B Stirling | 16,962 | 767 | — | 159,973 | 140,307 |

1 The pension entitlement shown is that which would be paid annually on retirement at normal retirement age (or immediately upon late retirement where applicable), based on service to 31 December 2005 (the date the scheme was closed to future accrual) and excluding any future increases under the Rules of the Scheme.
2 Transfer values have been calculated in accordance with Section 93A of the Pension Schemes Act 1993 and have been calculated in accordance with the Occupational Pension Schemes (Transfer Value) Regulations 1996, on the basis agreed with the Trustees of the Scheme, assuming that benefits in the future continue RPI-linked.
3 The change in the transfer value over the year includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as changes in financial conditions.

The following is additional information relating to Directors' pensions from the Scheme:
a) Before the Scheme closed, members of the Scheme had the option of paying Additional Voluntary Contributions (AVCs). The value of these AVCs has been excluded from the above figures.
b) Normal retirement age is 65.
c) On death before retirement, a spouse's pension is payable of one-half of the member's preserved pension at leaving, revalued from leaving date to the date of death.
On death in retirement, a spouse's pension is payable of one-half of the member's pension at death, without reduction for any part of the member's pension surrendered for cash at retirement.
d) Members' Guaranteed Minimum Pensions increase at statutory rates. Other pensions increase at 5% per annum or the increase in the Retail Price Index if less.
e) From 1 January 2006, active employees were able to pay contributions to a defined contribution scheme set up by the Company in order to receive retirement benefits. The Company also contributes to this arrangement. Details of this arrangement and the value of any contributions paid to this arrangement are not included in the above disclosures.

The Executive Directors are members of the Zotefoams Defined Contribution Alternative Pension Plan. Under a salary sacrifice agreement all contributions to this pension plan are paid by the Company and the contributions made by the Company in 2010 are shown in the table of Directors' Emoluments.

**Approval**
The report was approved by the Board of Directors on 7 March 2011 and signed on its behalf by:

**R J Clowes**
Non-executive Director and Chairman of the Remuneration Committee

Company number: 2714645

# Audit Committee Report

**Summary of the role of the Audit Committee**
The Audit Committee is appointed by the Board from the independent non-executive Directors of the Company. The Audit Committee's terms of reference include all matters indicated by the Disclosure and Transparency Rule 7.1 and the Combined Code. The terms of reference are considered annually by the Audit Committee and are then referred to the Board for approval.

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

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

**Composition of the Audit Committee**
The members of the Audit Committee in 2010 were the independent non-executive Directors of the Company, R H Lawson and R J Clowes. D A Campbell was also a member of the Committee until his death on 29 November 2010. R H Lawson is Chairman of the Committee and is a Fellow of the Institute of Chartered Accountants in England and Wales.

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

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

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

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

**Overview of the actions taken by the Audit Committee to discharge its duties**
Since the beginning of 2010 the Audit Committee has:
- reviewed the financial statements in the 2009 and 2010 report and accounts and the interim report issued in August 2010. As part of this review the Committee received reports from the external auditor on the audit of the Annual Reports and Accounts and the review of the interim report;
- considered the output from the Group-wide process used to identify, evaluate and mitigate high level business risks;
- undertaken an assessment of the need for an internal audit function; and
- following this assessment appointed an internal auditor and agreed a programme of work for 2010;
- received reports from the internal auditor on the work it had undertaken and management responses to proposals made in the internal audit report;
- reviewed the effectiveness of the Group's internal controls (including, but not limited to, financial controls) and disclosures made in the Annual Report on this matter;
- reviewed and agreed the scope of the audit work to be undertaken by the external auditor;
- considered the views of the external auditor on the effectiveness of the Group's internal financial controls;
- agreed the fees to be paid to the external auditor for their audit and work on the accounts and interim report;
- undertaken an evaluation of the independence and effectiveness of the external auditor; and
- reviewed its own effectiveness.

# **Audit Committee Report** continued

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

**Internal audit function**
The Audit Committee reviewed the need for an internal audit function. Although it concluded that given the size of the Group the creation of a separate internal audit function was not necessary it did appoint an external accountancy firm, Mazars, to carry out an internal audit review of some of the Company's financial controls in 2010. Mazars carries out no other work for the Group and the Audit Committee considers them independent.

The Audit Committee agreed with Mazars their terms of reference, reporting lines and their planned activity. It then reviewed the outcome of this work with Mazars and the findings and proposals made by Mazars with management.

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

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

**R H Lawson**
Non-executive Director and Chairman of the Audit Committee
7 March 2011

# Corporate Social Responsibility Report

Zotefoams considers that the management of safety, health, environmental, social and ethical matters forms a key element of effective corporate governance. These areas are covered by the internal control systems and procedures outlined in the Corporate Governance Report on page 33.

**Safety, Health and Environment (SHE)**
The Board has separate policies in place relating to Safety, Health 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 its quarterly reporting programme.

In 2010 the Finance Director for the first half of the year and then the Managing Director for the second half of the year were directly responsible to the Board for Safety, Health and Environmental performance. Site Committees meet at least quarterly to consider all SHE matters and Steering Committees, chaired by the Managing Director (or appropriate responsible person in subsidiary companies), also meet quarterly to consider overall performance and the impact of current and impending legislation. A Health and Safety Adviser and an Environmental Adviser support these groups.

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

We take reporting of all incidents very seriously, including ‘near misses’ and plant or equipment damage not resulting in personal injury. All events are investigated by appropriate levels of management to establish root cause and to eliminate re-occurrence wherever possible. There were no prosecutions, fines or enforcement action taken as a result of non-compliance with safety, health or environmental legislation.

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

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

In 2010 there were five reportable lost time injuries in the Group. All were related to trips and falls with different causes. All have been fully investigated and appropriate corrective actions are being taken.

| Year | **2010** | 2009 | 2008 |
|---|---|---|---|
| Reportable lost time injuries | **5** | 2 | 8 |

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

During 2010 the Group had 15 internally recorded environmental incidents (2009: 13). Five of these were noise or other complaints (2009: 7). All were investigated and actions taken. Five were minor chemical or oil spills (2009: 2) which were dealt with appropriately and had no significant environmental impact. Five were releases of nitrogen gas into the air from bursting disks which are an essential part of our statutory equipment safety regime (2009: 4). 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.

The vast majority of all waste produced by Zotefoams plc is either solid or foamed polyolefin. Neither are easily melt-processed (the major recycling route for most plastics) due to our essential step of cross-linking our polymers during manufacture.

In 2010 the waste sent to landfill for our main site in Croydon was 687 tonnes, higher than 2009 (432 tonnes) reflecting both higher production volumes and the impact of our site-wide clean-up under our lean manufacturing initiative.

We have improved our monitoring and measurement of water consumption in the year.

# **Corporate Social Responsibility Report** continued

Energy consumption is monitored and reviewed regularly. There are continuing efforts across the site to improve energy efficiency and in 2010 we improved our energy consumption per kg produced by 9%. In October 2009 Zotefoams entered into a Climate Change Levy (CCL) agreement. This involves the Company meeting specific targets to reduce energy consumption. Providing Zotefoams meets the requirements of the CCL agreement it receives a rebate on its electricity bills and is also exempt from the Carbon Reduction Commitment Scheme.

| Croydon site: | **2010** | 2009 | 2008 |
|---|---|---|---|
| Internally recorded environmental incidents | **15** | 13 | 4 |
| Waste sent to landfill (tonnes) | **687** | 432 | 337 |
| Water consumption (000s $m^3$) | **48** | 57 | 92 |
| Energy consumption (Kwhr/Kg) | **12.5** | 13.8 | 13.2 |

### Employees

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

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

### Business ethics

Zotefoams is committed to high standards of business conduct and seeks to maintain these standards across all of its operations throughout the world. Guidance on business ethics is included in the employee handbook and incorporated into an induction process which all employees must complete. Anti-bribery, anti-trust (anti non-competitive trading practices) and whistleblowing (for the reporting of possible improprieties) policies are also included in the employee handbook.

# Corporate Governance

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

**Statement of compliance with the Combined Code**
Throughout the year ended 31 December 2010 the Company has been in compliance with the Code provisions set out in Section 1 of the Code.

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

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

All Directors must take decisions objectively in the interests of the Company.

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

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

Attendance details for 2010 by the Directors for meetings of the Board and these Committees are shown below:

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

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

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

**Board balance and independence**
The Board structure comprises, in addition to Executive Directors, two independent non-executive Directors and a non-executive Chairman. It is the intention of the Company to appoint a third independent non-executive Director.

The Chairman, N G Howard, is also Chairman of the Nominations Committee and a member of the Remuneration Committee. N G Howard was independent on his appointment as Chairman. No-one other than the Committee Chairman and members is entitled to be present at a meeting of the Remuneration, Audit and Nominations Committees, but others may attend at the invitation of the Committees. During the year the Chairman met with the non-executive Directors without the Executive Directors present and the non-executive Directors met without the Chairman being present.

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

# **Corporate Governance** continued

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

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

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

**Re-election**
Re-election of Board members is required at the first AGM following appointment and at least every three years thereafter. At the AGM in 2011 two Directors will stand for re-election:
- R J Clowes;
- R H Lawson.

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

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

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

**Going concern**
The Company's business activities, together with the factors likely to affect it's future development, performance and position are set out in the Business Review on pages 14 to 19. This also describes the financial position of the Company, its cash flows and liquidity position. In addition, notes 21 to 26 to the financial statements include the Company's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities, borrowing facilities, and its exposure to credit risk and liquidity risk. As a consequence, the Directors believe that the Company is well placed to manage its business risks.

The Directors therefore have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

# Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU and applicable law and have elected to prepare the Parent Company financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Parent Company and of their profit or loss for that period. In preparing each of the Group and Parent Company financial statements, the Directors are required to:
- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

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

The Directors of Zotefoams plc are detailed on page 20.

By order of the Board

**C G Hurst**
Finance Director

# Independent Auditor's Report

To the members of Zotefoams plc

We have audited the financial statements of Zotefoams plc for the year ended 31 December 2010 set out on pages 38 to 71. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the EU and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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**

As explained more fully in the Statement of Directors' Responsibilities set out on page 36, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/private.cfm.

**Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2010 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

**Opinion on other matters prescribed by the Companies Act 2006**

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 36, in relation to going concern;
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

**D A Bowen (Senior Statutory Auditor)**
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
Crawley
7 March 2011

# Consolidated Income Statement

for the year ended 31 December 2010

| | Note | **Pre-exceptional items 2010 £000** | **Exceptional items (see note 4) 2010 £000** | **Total 2010 £000** | Pre-exceptional items 2009 £000 | Exceptional items (see note 4) 2009 £000 | Total 2009 £000 |
|---|---|---|---|---|---|---|---|
| **Revenue** | 2 | **39,879** | **—** | **39,879** | 31,816 | — | 31,816 |
| Cost of sales | | **(28,430)** | **—** | **(28,430)** | (21,941) | (312) | (22,253) |
| **Gross profit/(loss)** | | **11,449** | **—** | **11,449** | 9,875 | (312) | 9,563 |
| Distribution costs | | **(3,220)** | **—** | **(3,220)** | (2,745) | (38) | (2,783) |
| Administrative expenses | | **(3,403)** | **—** | **(3,403)** | (3,714) | (59) | (3,773) |
| **Operating profit/(loss)** | | **4,826** | **—** | **4,826** | 3,416 | (409) | 3,007 |
| Financial income | 6 | **1,116** | **—** | **1,116** | 810 | — | 810 |
| Finance costs | 6 | **(1,329)** | **—** | **(1,329)** | (1,168) | — | (1,168) |
| Deemed disposal of associate interest | | **—** | **1,098** | **1,098** | — | — | — |
| Share of profit from associate | | **88** | **—** | **88** | 99 | — | 99 |
| **Profit/(loss) before tax** | | **4,701** | **1,098** | **5,799** | 3,157 | (409) | 2,748 |
| Taxation | 7 | **(995)** | **—** | **(995)** | (690) | 106 | (584) |
| **Profit/(loss) for the year** | 3 | **3,706** | **1,098** | **4,804** | 2,467 | (303) | 2,164 |
| Attributable to: | | | | | | | |
| Equity holders of the parent | | **3,729** | **1,098** | **4,827** | 2,467 | (303) | 2,164 |
| Non-controlling interest | | **(23)** | **—** | **(23)** | — | — | — |
| | | **3,706** | **1,098** | **4,804** | 2,467 | (303) | 2,164 |
| **Earnings per share** | | | | | | | |
| **Basic (p)** | 8 | | | **13.1** | | | 5.9 |
| **Diluted (p)** | 8 | | | **12.8** | | | 5.8 |

# Consolidated Statement of Comprehensive Income

for the year ended 31 December 2010

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Profit for the year | **4,804** | 2,164 |
| **Other comprehensive income** | | |
| Foreign exchange translation differences on investment in foreign subsidiary/associate | **(402)** | (1,251) |
| Effective portion of changes in fair value of cash flow hedges net of recycling | **(33)** | 1,228 |
| Actuarial gains/(losses) on defined benefit schemes | **308** | (2,698) |
| Tax relating to components of other comprehensive income | **(77)** | 411 |
| Other comprehensive income/(expenditure) for the period, net of tax | **(204)** | (2,310) |
| **Total comprehensive income/(expenditure) for the year** | **4,600** | (146) |
| Attributable to: | | |
| Equity holders of the parent | **4,844** | (146) |
| Non-controlling interest | **(244)** | — |
| **Total comprehensive income/(expenditure) for the year** | **4,600** | (146) |

# Company Statement of Comprehensive Income

for the year ended 31 December 2010

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Profit for the year | **3,274** | 1,310 |
| **Other comprehensive income** | | |
| Effective portion of changes in fair value of cash flow hedges net of recycling | **(33)** | 1,228 |
| Actuarial gains/(losses) on defined benefit schemes | **308** | (2,698) |
| Tax relating to components of other comprehensive income | **(77)** | 411 |
| Other comprehensive income/(expenditure) for the period, net of tax | **198** | (1,059) |
| **Total comprehensive income for the year** | **3,472** | 251 |
| Attributable to equity holders of the Company | **3,472** | 251 |

# Consolidated Statement of Financial Position

as at 31 December 2010

| | Note | 2010 £000 | 2009 £000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | **25,597** | 25,829 |
| Intangible assets | 11 | **7,168** | 75 |
| Investment in associate | 13 | **—** | 1,687 |
| Deferred tax assets | 19 | **352** | 249 |
| **Total non-current assets** | | **33,117** | 27,840 |
| **Current assets** | | | |
| Inventories | 14 | **4,134** | 4,382 |
| Trade and other receivables | 15 | **9,463** | 7,729 |
| Cash and cash equivalents | 16 | **4,716** | 2,975 |
| **Total current assets** | | **18,313** | 15,086 |
| **Total assets** | | **51,430** | 42,926 |
| **Non-current liabilities** | | | |
| Interest-bearing loans and borrowings | 18 | **(1,488)** | (2,134) |
| Employee benefits | 23 | **(4,959)** | (5,783) |
| Deferred tax liabilities | 19 | **(1,317)** | (1,377) |
| **Total non-current liabilities** | | **(7,764)** | (9,294) |
| **Current liabilities** | | | |
| Interest-bearing loans and borrowings | 18 | **(660)** | (660) |
| Bank overdraft | 16 | **(711)** | (611) |
| Tax payable | | **(709)** | (547) |
| Trade and other payables | 17 | **(4,989)** | (4,132) |
| **Total current liabilities** | | **(7,069)** | (5,950) |
| **Total liabilities** | | **(14,833)** | (15,244) |
| **Total net assets** | | **36,597** | 27,682 |
| **Equity** | | | |
| Issued share capital | 20 | **1,915** | 1,915 |
| Own shares held | | **(69)** | (95) |
| Share premium | | **13,941** | 13,941 |
| Capital redemption reserve | | **15** | 15 |
| Translation reserve | | **859** | 1,040 |
| Hedging reserve | | **(69)** | (36) |
| Retained earnings | | **14,630** | 10,902 |
| **Total equity attributable to the equity holders of the parent** | | **31,222** | 27,682 |
| **Non-controlling interest** | | **5,375** | — |
| **Total equity** | | **36,597** | 27,682 |

These financial statements were approved by the Board of Directors on 7 March 2011 and signed on its behalf by:

**N G Howard**
Chairman

**C G Hurst**
Finance Director

Company number: 2714645

# Company Statement of Financial Position

as at 31 December 2010

| | Note | 2010 £000 | 2009 £000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | **21,023** | 21,000 |
| Intangible assets | 11 | **25** | 75 |
| Investment in subsidiaries | 12 | **8,015** | 7,888 |
| **Total non-current assets** | | **29,063** | 28,963 |
| **Current assets** | | | |
| Inventories | 14 | **3,172** | 3,555 |
| Trade and other receivables | 15 | **8,989** | 7,969 |
| Cash and cash equivalents | 16 | **3,998** | 2,718 |
| **Total current assets** | | **16,159** | 14,242 |
| **Total assets** | | **45,222** | 43,205 |
| **Non-current liabilities** | | | |
| Interest-bearing loans and borrowings | 18 | **(1,488)** | (2,134) |
| Employee benefits | 23 | **(4,959)** | (5,783) |
| Deferred tax liabilities | 19 | **(1,317)** | (1,377) |
| **Total non-current liabilities** | | **(7,764)** | (9,294) |
| **Current liabilities** | | | |
| Interest-bearing loans and borrowings | 18 | **(4,035)** | (3,508) |
| Bank overdraft | 16 | **(711)** | (611) |
| Tax payable | | **(696)** | (547) |
| Trade and other payables | 17 | **(4,559)** | (3,956) |
| **Total current liabilities** | | **(10,001)** | (8,622) |
| **Total liabilities** | | **(17,765)** | (17,916) |
| **Total net assets** | | **27,457** | 25,289 |
| **Equity** | | | |
| Issued share capital | 20 | **1,915** | 1,915 |
| Own shares held | | **(69)** | (95) |
| Share premium | | **13,941** | 13,941 |
| Capital redemption reserve | | **15** | 15 |
| Hedging reserve | | **(69)** | (36) |
| Retained earnings | | **11,724** | 9,549 |
| **Total equity attributable to the equity holders of the Company** | | **27,457** | 25,289 |

These financial statements were approved by the Board of Directors on 7 March 2011 and signed on its behalf by:

**N G Howard**
Chairman

**C G Hurst**
Finance Director

Company number: 2714645

# Consolidated Statement of Cash Flows

for the year ended 31 December 2010

| | Note | 2010 £000 | 2009 £000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit for the year | | **4,804** | 2,164 |
| Adjustments for: | | | |
| Depreciation, amortisation and impairment | | **3,260** | 3,588 |
| Gain on deemed sale of interest in MuCell Extrusion LLC | | **(1,098)** | — |
| Loss on sale of plant and equipment | | **10** | 90 |
| Financial income | | **(1,116)** | (810) |
| Finance costs | | **1,329** | 1,168 |
| Share of income from associate | | **(88)** | (99) |
| Equity-settled share-based payments | | **170** | 211 |
| Taxation | | **995** | 584 |
| **Operating profit before changes in working capital and provisions** | | **8,266** | 6,896 |
| (Increase)/decrease in trade and other receivables | | **(1,314)** | 577 |
| Decrease/(increase) in inventories | | **312** | (152) |
| Increase in trade and other payables | | **622** | 435 |
| Decrease in provisions and employee benefits | | **(660)** | (715) |
| **Cash generated from operations** | | **7,226** | 7,041 |
| Interest paid | | **(83)** | (110) |
| Tax paid | | **(986)** | (1,123) |
| **Net cash from operating activities** | | **6,157** | 5,808 |
| Interest received | | **16** | 18 |
| Proceeds from disposal of plant and equipment | | **12** | — |
| Acquisition of property, plant and equipment | | **(2,668)** | (3,431) |
| Distribution from associate | | **82** | 104 |
| **Net cash used in investing activities** | | **(2,558)** | (3,309) |
| Proceeds from issue of share capital | | **430** | — |
| Repurchase of own shares | | **(334)** | — |
| New borrowings | | **—** | 3,289 |
| Repayment of borrowings | | **(660)** | (795) |
| Cash deemed to have been acquired | | **332** | — |
| Distribution by subsidiary to non-controlling interest | | **(134)** | — |
| Dividends paid | | **(1,653)** | (1,638) |
| **Net cash used in financing activities** | | **(2,019)** | 856 |
| Net increase in cash and cash equivalents | | **1,580** | 3,355 |
| **Cash and cash equivalents at 1 January** | | **2,364** | (852) |
| Effect of exchange rate fluctuations on cash held | | **61** | (139) |
| **Cash and cash equivalents at 31 December** | 16 | **4,005** | 2,364 |

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

# Company Statement of Cash Flows

for the year ended 31 December 2010

| | Note | 2010 £000 | 2009 £000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit for the year | | **3,274** | 1,310 |
| Adjustments for: | | | |
| Depreciation, amortisation and impairment | | **2,648** | 2,939 |
| Foreign exchange (gains)/losses | | **(125)** | 496 |
| Loss on sale of plant and equipment | | **10** | 92 |
| Financial income | | **(1,199)** | (891) |
| Finance costs | | **1,385** | 1,200 |
| Equity-settled share-based payments | | **170** | 211 |
| Taxation | | **1,069** | 581 |
| **Operating profit before changes in working capital and provisions** | | **7,232** | 5,938 |
| Increase in trade and other receivables | | **(1,056)** | (193) |
| Decrease/(increase) in inventories | | **383** | (171) |
| Increase in trade and other payables | | **570** | 530 |
| Decrease in provisions and employee benefits | | **(660)** | (715) |
| **Cash generated from operations** | | **6,469** | 5,389 |
| Interest paid | | **(139)** | (142) |
| Tax paid | | **(970)** | (1,110) |
| **Net cash flow from operating activities** | | **5,360** | 4,137 |
| Interest received | | **99** | 99 |
| Proceeds from disposal of plant and equipment | | **11** | — |
| Acquisition of property, plant and equipment | | **(2,610)** | (3,358) |
| **Net cash used in investing activities** | | **(2,500)** | (3,259) |
| Proceeds from issue of share capital | | **430** | 26 |
| Purchase of own shares | | **(334)** | (26) |
| Intercompany loan received | | **527** | 1,631 |
| New borrowings | | **—** | 3,289 |
| Repayment of borrowings | | **(660)** | (795) |
| Dividends paid | | **(1,653)** | (1,638) |
| **Net cash used in financing activities** | | **(1,690)** | 2,487 |
| Net increase in cash and cash equivalents | | **1,170** | 3,365 |
| **Cash and cash equivalents at 1 January** | | **2,107** | (1,250) |
| Effect of exchange fluctuations on cash held | | **10** | (8) |
| **Cash and cash equivalents at 31 December** | 16 | **3,287** | 2,107 |

# Consolidated Statement of Changes in Equity

for the year ended 31 December 2010

| | | Attributable to owners of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital £000 | Own shares held £000 | Share premium £000 | Capital redemption reserve £000 | Translation reserve £000 | Hedging reserve £000 | Retained earnings £000 | Total £000 | Non-controlling interest £000 | Total equity £000 |
| Balance at 1 January 2009 | | 1,889 | (69) | 13,941 | 15 | 2,291 | (1,264) | 12,418 | 29,221 | — | 29,221 |
| Shares issued | | 26 | (26) | — | — | — | — | — | — | — | — |
| Total recognised income and expense | | — | — | — | — | (1,251) | 1,228 | (123) | (146) | — | (146) |
| Equity-settled share-based payment transactions net of tax | | — | — | — | — | — | — | 245 | 245 | — | 245 |
| Dividends | 8 | — | — | — | — | — | — | (1,638) | (1,638) | — | (1,638) |
| **Balance at 31 December 2009** | | 1,915 | (95) | 13,941 | 15 | 1,040 | (36) | 10,902 | 27,682 | — | 27,682 |
| Balance at 1 January 2010 | | 1,915 | (95) | 13,941 | 15 | 1,040 | (36) | 10,902 | 27,682 | — | 27,682 |
| Non-controlling interest on deemed acquisition | | — | — | — | — | — | — | — | — | 5,753 | 5,753 |
| Shares issued | | — | 39 | — | — | — | — | 391 | 430 | — | 430 |
| Shares Acquired | | — | (13) | — | — | — | — | (321) | (334) | — | (334) |
| Total recognised income and expense | | — | — | — | — | (181) | (33) | 5,058 | 4,844 | (244) | 4,600 |
| Equity-settled share-based payment transactions net of tax | | — | — | — | — | — | — | 253 | 253 | — | 253 |
| Dividends | 8 | — | — | — | — | — | — | (1,653) | (1,653) | (134) | (1,787) |
| **Balance at 31 December 2010** | | **1,915** | **(69)** | **13,941** | **15** | **859** | **(69)** | **14,630** | **31,222** | **5,375** | **36,597** |

The aggregate current and deferred tax relating to items that are credited to equity is £10,000 (2009: a credit of £452,000).

# Company Statement of Changes in Equity

for the year ended 31 December 2010

| | Note | Share capital £000 | Own shares held £000 | Share premium £000 | Capital redemption reserve £000 | Hedging reserve £000 | Retained earnings £000 | Total equity £000 |
|---|---|---|---|---|---|---|---|---|
| Balance at 1 January 2009 | | 1,889 | (69) | 13,941 | 15 | (1,264) | 11,919 | 26,431 |
| Shares issued | | 26 | (26) | — | — | — | — | — |
| Total recognised income and expense | | — | — | — | — | 1,228 | (977) | 251 |
| Equity-settled share-based payment transactions net of tax | | — | — | — | — | — | 245 | 245 |
| Dividends | 8 | — | — | — | — | — | (1,638) | (1,638) |
| **Balance at 31 December 2009** | | 1,915 | (95) | 13,941 | 15 | (36) | 9,549 | 25,289 |
| Balance at 1 January 2010 | | 1,915 | (95) | 13,941 | 15 | (36) | 9,549 | 25,289 |
| Shares issued | | — | 39 | — | — | — | 391 | 430 |
| Shares acquired | | — | (13) | — | — | — | (321) | (334) |
| Total recognised income and expense | | — | — | — | — | (33) | 3,505 | 3,472 |
| Equity-settled share-based payment transactions net of tax | | — | — | — | — | — | 253 | 253 |
| Dividends | 8 | — | — | — | — | — | (1,653) | (1,653) |
| **Balance at 31 December 2010** | | **1,915** | **(69)** | **13,941** | **15** | **(69)** | **11,724** | **27,457** |

The aggregate current and deferred tax relating to items that are credited to equity is £10,000 (2009: a credit of £452,000).

# Notes to the Financial Statements

**1. Accounting policies**
Zotefoams plc (the 'Company') is a Company incorporated in Great Britain.

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

Both Parent Company financial statements and the Group financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ('Adopted IFRS'). On publishing the Parent Company financial statements here together with the Group financial statements the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual Income Statement and related notes that form part of these approved financial statements.

These financial statements were approved by the Board on 7 March 2011.

Judgements made by the Directors, in the application of these accounting policies that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year, are discussed in note 26.

The Directors consider the use of the going concern basis of accounting is appropriate because they have identified no material uncertainties related to events or conditions that may cast significant doubt about the ability of the Group to continue as a going concern. See the Corporate Governance report on page 33.

a) Measurement convention
The financial statements are prepared on the historical cost basis with the following exceptions:
- derivative financial instruments are stated at their fair value
- intangible assets acquired from a business combination are capitalised at their fair value as at the date of acquisition.

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

ii) Associates
Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20% and 50% of the voting power of another entity. Associates are accounted for using the equity method (equity accounted investees) and are initially recognised at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Group's share of the total recognised income and expense and equity movements of equity accounted investees, from the date that significant influence commences until the date that significant influence (or joint control) ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an investee.

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

iv) Accounting for business combinations
From 1 January 2010 the Group has applied IFRS3 Business Combinations (2008) in accounting for business combinations. The change in accounting policy has been applied prospectively and has had no material impact on earnings per share. Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

For acquisitions on or after 1 January 2010, the Group measures goodwill at the acquisition date as:
- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interests in the acquiree; plus
- if the business combination is achieved in stages, the fair value of the existing equity
- interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss. The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss. Costs related to the acquisition, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

# **Notes to the Financial Statements** continued

**1. Accounting policies** continued
Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognised in profit or loss.

When share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree employees (acquiree awards) and relate to past services, then all or a portion of the amount of the acquirer replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market based value of the replacement awards compared with the market-based value of the acquiree awards and the extent to which the replacement awards relate to past and/or future service.

*Acquisitions and disposals of non-controlling interests*
Acquisitions and disposals of non-controlling interests that do not result in a change of control are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognised as a result of such transactions. The adjustments to non-controlling interests are based on a proportionate amount of the net assets of the subsidiary. Any difference between the price paid or received and the amount by which non-controlling interests are adjusted is recognised directly in equity and attributed to the owners of the parent.

Prior to the adoption of IAS27 (2008), goodwill was recognised on the acquisition of non-controlling interests in a subsidiary, which represented the excess of the cost of the additional investment over the carrying amount of the interest in the net assets acquired at the date of the transaction.

**c) Foreign currency**
i) Foreign currency transactions
Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the time of the transaction.

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

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

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

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

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

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

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

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

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

**f) Investments in subsidiaries**
Investments in subsidiaries are stated at cost less provision for impairment.

**1. Accounting policies** continued

**g) Property, plant and equipment**

i) Owned assets

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

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

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

ii) Leased assets

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

iii) Depreciation

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

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

**h) Intangible assets**

i) Research and development

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

ii) Goodwill

Goodwill represents the excess of the cost of acquisition over the fair value of the Group's interest in the identifiable assets, liabilities and contingent liabilities acquired in a business combination. Goodwill is stated at the amount recognised on acquisition date less any accumulated impairment losses.

iii) Other intangible assets

Intangible assets acquired from a business combination are capitalised at fair value as at the date of acquisition and amortised over their estimated useful economic life. Their carrying value is the fair value at acquisition less cumulative amortisation and any impairment. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably. The estimated useful lives of the intangible assets are as follows:

| | |
|---|---|
| Marketing related | 5–15 years |
| Customer related | 2–10 years |
| Technology related | 5–20 years |

Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Other intangible assets that are purchased by the Group and have finite useful lives are measured at cost less accumulated amortisation and accumulated impairment losses. The cost is the purchase price of the asset. Amortisation is charged to the Income Statement on a straight line basis over the estimated useful lives of the assets. Expenditure on internally generated goodwill and brands is recognised in the Income Statement as an expense as incurred.

**i) Trade and other receivables**

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

**j) Inventories**

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

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

# **Notes to the Financial Statements** continued

**1. Accounting policies** continued

**k) Cash and cash equivalents**

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

**l) Impairment**

The carrying amounts of the Group's assets, other than inventories (see accounting policy (j)), employee benefits (see accounting policy (o)) and deferred tax assets (see accounting policy (t)), are reviewed at each balance sheet date where there is an indication that the asset may be impaired. If any such indication exists, the asset's recoverable amount is estimated (see below).

For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. An impairment loss is recognised if the carrying amount of an asset or its related cash-generating unit (CGU) exceeds its estimated recoverable amount.

i) Calculation of recoverable amount

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

ii) Impairment losses

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs), and then to reduce the carrying amounts of the other assets in the CGU (group of CGUs) on a pro rata basis.

iii) Reversals of impairment

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

**m) Dividends**

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

**n) Interest-bearing borrowings**

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

**o) Employee benefits**

i) Defined contribution plans

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

ii) Defined benefits plans

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

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

**1. Accounting policies** continued

iii) Share-based payment transactions

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

iv) Own shares held by Employee Benefit Trust

Transactions of the Company-sponsored EBT are treated as being those of the Company and are therefore reflected in the Parent Company and Group financial statements. In particular, the trust's purchases and sales of shares in the Company are debited and credited directly to equity.

**p) Trade and other payables**

Trade and other payables are stated at cost.

**q) Revenue**

Revenue from the sale of goods is recognised in the Income Statement at the point of despatch when significant risks and rewards of ownership is deemed to have been transferred to the buyer. MuCell Extrusion LLC recognises licence revenue upon transfer of the MuCell® technology provided that no significant Company obligations remain, the licence amount is determinable, and the collection of the related receivable is probable. Royalty income is based on the terms of the licence agreements and is recorded when amounts are determinable and collection of the related receivable is probable. Revenue from equipment sales is recognised upon shipment provided that collectability is probable and there are no significant post-delivery obligations or uncertainties. Revenue from consulting services is recognised either as the services are performed or upon the achievement of a specific milestone. Payments received under these arrangements prior to the completion of the related work are recorded as deferred income.

**r) Expenses**

i) Operating lease payments

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

ii) Finance lease payments

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

**s) Exceptional items**

Exceptional items are those significant items which in management's judgement are highlighted by virtue of their size and/or incidence to enable a full understanding of the Group's financial performance. Such items are included within the Income Statement caption to which they relate.

**t) Taxation**

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

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

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

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

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

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

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

# **Notes to the Financial Statements** continued

**1. Accounting policies** continued

**u) Changes in accounting policies**

The following standards and amendments to existing standards have been adopted for the first time in these financial statements:

- IFRS3 Business Combinations (2008) and consequential amendments to IAS27 Consolidated and Separate Financial Statements, IAS28 Investments in Associates, IAS31 Interests in Joint Ventures, IFRS2 Share-based Payment and IAS38 Intangible Assets – the amendments have been applied prospectively. See Note 1(b)(iv) for further details.

A number of other new standards, amendments to existing standards and interpretations are also effective for the year ended 31 December 2010, but have had no significant impact on the Group's financial statements.

**v) Adopted IFRS not yet applied**

At the date of approval of these financial statements, the following standards, interpretations and amendments were issued but not yet mandatory for the Group and early adoption has not been applied.

International Financial Reporting Interpretations Committee ('IFRIC') interpretations
- IFRIC19, Extinguishing Financial Liabilities with Equity Instruments

Amendments to existing standards
- Amendment to IAS24, Related Party Disclosures
- Amendment to IAS32, Classification of Rights Issues
- Amendment to IFRS7, Financial Instruments: Disclosure
- Amendment to IFRIC14, Prepayments of a Minimum Funding Requirement
- Amendment to IFRIC13, Customer Loyalty Programmes
- Amendment to IAS34, Interim Financial Reporting
- Annual Improvements to IFRSs 2010

It is considered that the above standards, amendments and interpretations will not have a significant effect on the results or net assets of the Group.

All the IFRSs, IFRIC interpretations and amendments to existing standards are endorsed by the EU at the date of approval of these financial statements with the exception of the amendment to IFRS7 and the Annual Improvements to IFRSs 2010.

**2. Segment reporting**

The Group manufactures and sells high-performance foams and licenses related technology for specialist markets worldwide. Zotefoams activities are categorised as follows:
- Polyolefins: these foams are made from olefinic homopolymer and copolymer resin. The most common resin used is polyethylene.
- High-performance polymers (HPP): these foams exhibit high-performance on certain key properties, such as improved chemical, flammability or temperature performance, due to the resins on which they are based. Turnover in the segment is currently mainly derived from our ZOTEK® F foams and T-Tubes® insulation both made from PVDF fluoropolymer. Other products either commercially launched or being assessed in development include foams made from polyamide (nylon) and Pebax®. Also included in this segment is our microZOTE® closed-cell roll foams. Currently developed microZOTE® products are made using polyolefin resins. However management consider the markets, products and stage of business development sufficiently different from our Azote® polyolefin business to classify this development as part of the HPP business segment at present.
- MuCell Extrusion LLC ('MEL'): licenses microcellular foam technology and sells related machinery. The results below are those consolidated for the last six months of 2010.

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

**2. Segment reporting** continued

There are no transactions between reportable segments apart from the sale of minor equipment from MEL to microZOTE®, within our HPP segment.

| | Polyolefins | | HPP | | MEL | | Consolidated | |
|---|---|---|---|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Revenue from external customers | **36,784** | 30,174 | **2,485** | 1,642 | **610** | — | **39,879** | 31,816 |
| Pre-exceptional operating profit/(loss) | **5,285** | 3,933 | **(427)** | (517) | **(32)** | — | **4,826** | 3,416 |
| Exceptional items | | | | | | | **1,098** | (409) |
| Net financing costs | | | | | | | **(213)** | (358) |
| Profit/(loss) from associate | | | | | | | **88** | 99 |
| Taxation | | | | | | | **(995)** | (584) |
| Profit for the year | | | | | | | **4,804** | 2,164 |
| Segment assets | **38,580** | 37,740 | **4,746** | 4,937 | **7,752** | — | **51,078** | 42,677 |
| Unallocated assets | **—** | — | **—** | — | **—** | — | **352** | 249 |
| Total assets | | | | | | | **51,430** | 42,926 |
| Segment liabilities | **(12,626)** | (12,884) | **(111)** | (436) | **(70)** | — | **(12,807)** | (13,320) |
| Unallocated liabilities | **—** | — | **—** | — | **—** | — | **(2,026)** | (1,924) |
| Total liabilities | | | | | | | **(14,833)** | (15,244) |
| Depreciation | **2,868** | 3,437 | **235** | 105 | **8** | — | **3,111** | 3,542 |
| Capital expenditure | **1,952** | 1,922 | **711** | 1,509 | **5** | — | **2,668** | 3,431 |

**Geographical segments**

Polyolefins, HPP and MEL are managed on a worldwide basis but operate from UK and US locations. In presenting information on basis of geographical segments, segmental revenue is based on the geographical location of customers. Segment assets are based on the geographical location of assets.

| | UK and Eire £000 | Europe £000 | North America £000 | Rest of the world £000 | Total £000 |
|---|---|---|---|---|---|
| For the year ended 31 December 2010 | | | | | |
| Revenue from external customers | **7,721** | **19,277** | **9,765** | **3,116** | **39,879** |
| Segment assets | **35,941** | **—** | **15,489** | **—** | **51,430** |
| Capital expenditure | **2,572** | **—** | **96** | **—** | **2,668** |
| For the year ended 31 December 2009 | | | | | |
| Revenue from external customers | 6,503 | 15,428 | 8,218 | 1,667 | 31,816 |
| Segment assets | 33,793 | — | 9,133 | — | 42,926 |
| Capital expenditure | 3,359 | — | 72 | — | 3,431 |

**Major customer**

Revenues from one customer of the Group represents approximately £5,198k (2009: £4,186k) of the Group's total revenues.

# **Notes to the Financial Statements** continued

### 3. Expenses and auditors' remuneration

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Included in profit for the year are: | | |
| Research and development costs expensed | **875** | 776 |
| Net exchange (gains)/losses | **(77)** | 759 |
| Auditors' remuneration: | | |
| Group – audit of these financial statements | **94** | 90 |
| – fees receivable by the auditors and their associates in respect of other services: | | |
| – other services pursuant with legislation | **30** | 19 |
| – other services relating to taxation | **15** | 40 |
| – other services relating to acquisition of associate | **4** | — |
| | **143** | 149 |

### 4. Exceptional Items
The Company has classified the following as exceptional items:

**Acquisition of MuCell**
Relating to acquisition adjustments arising through revaluation of assets and translation reserves transferred to retained earnings.

Zotefoams Inc. owns 30% of the ownership units of MuCell Extrusion LLC. From 1 July 2010 Zotefoams has an option to purchase MuCell Extrusion LLC and is deemed to have a controlling interest under IFRS3 (revised). From 1 July 2010 MuCell Extrusion LLC has therefore been treated as a subsidiary.

**Restructuring costs**
Relating to termination payments, advisory and other associated costs for the termination of 33 employees in the first half of 2009.

**VAT**
Adjustment made in 2009 to exceptional item in prior year.

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Gain on deemed acquisition of MuCell Extrusion LLC | **1,098** | — |
| Restructuring costs | **—** | (439) |
| VAT adjustment | **—** | 30 |
| Exceptional items before taxation | **1,098** | (409) |
| Tax on above | **—** | 106 |
| Exceptional items after taxation | **1,098** | (303) |

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

| | Number of employees | | | |
|---|---|---|---|---|
| | Group | | Company | |
| | **2010** | 2009 | **2010** | 2009 |
| Production | **115** | 111 | **108** | 105 |
| Maintenance | **16** | 17 | **14** | 15 |
| Distribution and marketing | **45** | 43 | **37** | 34 |
| Administration and technical | **65** | 63 | **56** | 56 |
| | **241** | 234 | **215** | 210 |

**5. Staff numbers and expenses** continued

The aggregate payroll costs of these persons were as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Wages and salaries | **7,877** | 6,793 | **6,731** | 5,789 |
| Social security costs | **804** | 691 | **720** | 629 |
| Share-based payments | **206** | 260 | **206** | 260 |
| Other pension costs | **549** | 540 | **500** | 494 |
| | **9,436** | 8,284 | **8,157** | 7,172 |

The costs shown above exclude items classified as exceptional items.

Details of individual Directors' emoluments, pension costs and share options are dealt with on pages 26 to 28 in the Directors' Remuneration Report.

## 6. Finance income and costs

### Financial income

| | **2010 £000** | 2009 £000 |
|---|---|---|
| Interest on bank deposits | **16** | 18 |
| Expected return on assets of defined benefit pension fund | **1,100** | 792 |
| | **1,116** | 810 |

### Finance costs

| | **2010 £000** | 2009 £000 |
|---|---|---|
| On bank loans and overdrafts | **85** | 103 |
| Interest on defined benefit pension obligation | **1,244** | 1,065 |
| | **1,329** | 1,168 |

## 7. Taxation

| | Note | **2010 £000** | 2009 £000 |
|---|---|---|---|
| UK corporation tax | | **1,118** | 741 |
| Overseas taxation | | **29** | 13 |
| Adjustment to prior year UK tax charge | | **1** | (20) |
| Current taxation | | **1,148** | 734 |
| Deferred taxation | 19 | **(153)** | (150) |
| Total tax charge | | **995** | 584 |

### Factors affecting the tax charge

The tax charge for the year is lower (2009: lower) than the standard rate of corporation tax in the UK of 28.0% (2009: 28.0%). The differences are explained below:

| | **2010 £000** | 2009 £000 |
|---|---|---|
| Tax reconciliation | | |
| Profit before tax | **5,799** | 2,748 |
| Tax at 28.0% (2009: 28.0%) | **1,624** | 769 |
| Effects of: | | |
| Deemed disposal of associate interest not liable for tax | **(307)** | — |
| Research and development tax credits and other allowances less expenses not deductible for tax purposes | **(111)** | (69) |
| Overseas earnings and effect of US tax losses | **(212)** | (96) |
| Adjustments to UK corporation tax charge in respect of previous periods | **1** | (20) |
| Total tax charge | **995** | 584 |

# **Notes to the Financial Statements** continued

## 8. Dividends and earnings per share

| | **2010 £000** | 2009 £000 |
|---|---|---|
| Final dividend prior year of 3.0p (2008: 3.0p) net per 5.0p ordinary share | **1,100** | 1,091 |
| Interim dividend of 1.5p (2009: 1.5p) net per 5.0p ordinary share | **553** | 547 |
| Dividends paid during the year | **1,653** | 1,638 |

The proposed final dividend for the year ended 31 December 2010 of 3.15p per share (2009: 3.0p) is subject to approval by shareholders at the AGM and has not been included as a liability in these financial statements.

### Earnings per ordinary share

Earnings per ordinary share is calculated by dividing profit after tax attributable to equity holders of the Parent Company of £4,827,000 (2009: £2,164,000) by the weighted average number of shares in issue during the year excluding own shares held by employee trusts which are administered by independent trustees. The number of shares held in the trust at 31 December 2010 was 1,389,861 (2009: 1,891,147). Distribution of shares from the trust is at the discretion of the trustees. Diluted earnings per ordinary share adjusts for the potential dilutive effect of share option schemes in accordance with IAS 33.

| | **2010** | 2009 |
|---|---|---|
| Average number of ordinary shares issued | **36,727,932** | 36,402,886 |
| Deemed issued for no consideration | **982,816** | 1,001,188 |
| Diluted number of ordinary shares issued | **37,710,748** | 37,404,074 |

Shares deemed issued for no consideration have been calculated based on the potential dilutive effect of the Executive Share Option Scheme, options granted under the HMRC Approved Share Option Scheme, Long-Term Incentive Plans, the 2009 Share Bonus Plan and the Deferred Bonus Plan:

| | | Number of shares under option | |
|---|---|---|---|
| Date from which exercisable | Exercise price | **2010** | 2009 |
| 7 April 2007 | 72.5p | **59,631** | 152,834 |
| 22 December 2008 | 77.0p | **213,311** | 684,213 |
| 11 March 2010 | nil | **—** | 217,775 |
| 20 March 2011 | nil | **128,005** | 230,304 |
| 12 August 2011 | 106.7p | **249,998** | 253,044 |
| 16 March 2012 | nil | **465,355** | 516,387 |
| 11 March 2013 | nil | **25,484** | 30,165 |
| 19 March 2013 | nil | **214,093** | — |
| 19 March 2013 | 95.0p | **47,367** | — |
| | | **1,403,244** | 2,084,722 |

The average fair value of one ordinary share during the year was considered to be 123.5p (2009: 67.9p).

## 9. Profit for the financial year

The Group accounts do not include a separate Income Statement for Zotefoams plc (the parent undertaking) as permitted by Section 408 of the Companies Act 2006. The Parent Company profit after tax for the financial year is £3,274,000 (2009: £1,310,000).

### 10. Property, plant and equipment
a) Group

| | Land and buildings £000 | Plant and equipment £000 | Fixtures and fittings £000 | Under construction £000 | Total £000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2009 | 15,464 | 41,499 | 2,268 | 959 | 60,190 |
| Acquisitions | — | 292 | 143 | 2,900 | 3,335 |
| Disposals | — | (1,211) | (4) | — | (1,215) |
| Reclassifications | — | 2,129 | — | (2,129) | — |
| Effect of movement in foreign exchange | (535) | (536) | (24) | — | (1,095) |
| Balance at 31 December 2009 | 14,929 | 42,173 | 2,383 | 1,730 | 61,215 |
| Balance at 1 January 2010 | 14,929 | 42,173 | 2,383 | 1,730 | 61,215 |
| Acquisitions | — | 56 | 50 | 2,596 | 2,702 |
| Acquired on deemed acquisition of MEL | — | 33 | 10 | — | 43 |
| Disposals | — | (85) | (1) | — | (86) |
| Reclassifications | — | 2,468 | 75 | (2,543) | — |
| Effect of movement in foreign exchange | 136 | 136 | 7 | — | 279 |
| **Balance at 31 December 2010** | **15,065** | **44,781** | **2,524** | **1,783** | **64,153** |
| **Depreciation and impairment** | | | | | |
| Balance at 1 January 2009 | 5,608 | 25,875 | 1,932 | — | 33,415 |
| Depreciation charge for the year | 601 | 2,795 | 108 | 38 | 3,542 |
| Disposals | — | (1,122) | (3) | — | (1,125) |
| Reclassifications | — | 38 | — | (38) | — |
| Effect of movement in foreign exchange | (159) | (268) | (19) | — | (446) |
| Balance at 31 December 2009 | 6,050 | 27,318 | 2,018 | — | 35,386 |
| Balance at 1 January 2010 | 6,050 | 27,318 | 2,018 | — | 35,386 |
| Depreciation charge for the year | 604 | 2,204 | 122 | 181 | 3,111 |
| Disposals | — | (63) | (1) | — | (64) |
| Reclassifications | — | 173 | 8 | (181) | — |
| Effect of movement in foreign exchange | 42 | 76 | 5 | — | 123 |
| **Balance at 31 December 2010** | **6,696** | **29,708** | **2,152** | **—** | **38,556** |
| **Net book value** | | | | | |
| At 1 January 2009 | 9,856 | 15,624 | 336 | 959 | 26,775 |
| At 31 December 2009 and 1 January 2010 | 8,879 | 14,855 | 365 | 1,730 | 25,829 |
| **At 31 December 2010** | **8,369** | **15,073** | **372** | **1,783** | **25,597** |

Included in plant and machinery for both the Company and the Group are assets of £2,145,000 (2009: £2,805,000) pledged as security for a bank loan.

During the year both the Company and the Group commenced a number of programmes to construct and refurbish plant and equipment and fixtures and fittings. Costs incurred up to the balance sheet date totalled £1,783,000 (2009: £1,730,000) for the Group.

# **Notes to the Financial Statements** continued

## **10. Property, plant and equipment** continued
### b) Company

| | Land and buildings £000 | Plant and equipment £000 | Fixtures and fittings £000 | Under construction £000 | Total £000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2009 | 10,590 | 36,648 | 2,052 | 959 | 50,249 |
| Acquisitions | — | 246 | 117 | 2,900 | 3,263 |
| Disposals | — | (1,211) | (3) | — | (1,214) |
| Reclassifications | — | 2,129 | — | (2,129) | — |
| Balance at 31 December 2009 | 10,590 | 37,812 | 2,166 | 1,730 | 52,298 |
| Balance at 1 January 2010 | 10,590 | 37,812 | 2,166 | 1,730 | 52,298 |
| Acquisitions | — | 2 | 45 | 2,596 | 2,643 |
| Disposals | — | (85) | (1) | — | (86) |
| Reclassifications | — | 2,468 | 75 | (2,543) | — |
| **Balance at 31 December 2010** | **10,590** | **40,197** | **2,285** | **1,783** | **54,855** |
| **Depreciation and impairment** | | | | | |
| Balance at 1 January 2009 | 4,213 | 23,549 | 1,765 | — | 29,527 |
| Depreciation charge for the year | 421 | 2,346 | 88 | 38 | 2,893 |
| Disposals | — | (1,120) | (2) | — | (1,122) |
| Reclassifications | — | 38 | | (38) | |
| Balance at 31 December 2009 | 4,634 | 24,813 | 1,851 | — | 31,298 |
| Balance at 1 January 2010 | 4,634 | 24,813 | 1,851 | — | 31,298 |
| Depreciation charge for the year | 421 | 1,896 | 100 | 181 | 2,598 |
| Disposals | — | (63) | (1) | — | (64) |
| Reclassifications | — | 173 | 8 | (181) | — |
| **Balance at 31 December 2010** | **5,055** | **26,819** | **1,958** | **—** | **33,832** |
| **Net book value** | | | | | |
| At 1 January 2009 | 6,377 | 13,099 | 287 | 959 | 20,722 |
| At 31 December 2009 and 1 January 2010 | 5,956 | 12,999 | 315 | 1,730 | 21,000 |
| **At 31 December 2010** | **5,535** | **13,378** | **327** | **1,783** | **21,023** |

## **11. Intangible assets**
### Group

| | MuCell licence held by Zotefoams plc £000 | Marketing related £000 | Customer related £000 | Technology related £000 | Goodwill £000 | Total intangibles £000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| Balance at 1 January 2010 | 150 | — | — | — | — | 150 |
| Deemed acquisition of MEL | (150) | 211 | 167 | 3,610 | 3,595 | 7,433 |
| Effect of movement in foreign exchange | — | (8) | (6) | (139) | (138) | (291) |
| **Balance at 31 December 2010** | **—** | **203** | **161** | **3,471** | **3,457** | **7,292** |
| **Amortisation** | | | | | | |
| Balance at 1 January 2010 | 75 | — | — | — | — | 75 |
| Charge for the year | 25 | 10 | 13 | 101 | — | 149 |
| Adjustment on consolidation of MEL | (100) | — | — | — | — | (100) |
| **Balance at 31 December 2010** | **—** | **10** | **13** | **101** | **—** | **124** |
| **Net book value** | | | | | | |
| At 1 January 2010 | 75 | — | — | — | — | 75 |
| **At 31 December 2010** | **—** | **193** | **148** | **3,370** | **3,457** | **7,168** |

**11. Intangible assets** continued

**Company**

| | MuCell licence £000 |
|---|---|
| **Cost** | |
| Balance at 1 January 2010 | 150 |
| **Balance at 31 December 2010** | **150** |
| **Amortisation** | |
| Balance at 1 January 2010 | (75) |
| Charge for the year | (50) |
| **Balance at 31 December 2010** | **(125)** |
| **Net book value** | |
| At 1 January 2010 | 75 |
| **At 31 December 2010** | **25** |

**12. Investments in subsidiaries**

| | Company | |
|---|---|---|
| | **2010 £000** | 2009 £000 |
| Shares in Group undertakings – at cost | **7,157** | 7,157 |
| Provision against the value of investment in subsidiary to reflect the value of the underlying net assets | **(3,294)** | (3,294) |
| Loan to Group undertakings | **4,152** | 4,025 |
| | **8,015** | 7,888 |

The investments consist of the entire ordinary share capital of Zotefoams International Limited and a $6,500,000 loan (2009: $6,500,000) to Zotefoams Inc.

The movements in investments during the year were due to foreign exchange differences.

The following is a complete list of the subsidiary undertakings of the Company:

| | Ownership |
|---|---|
| Zotefoams International Limited | 100% |
| Zotefoams Inc. | 100% |
| MuCell Extrusion LLC | 30% |

Zotefoams International Limited is incorporated in Great Britain. Zotefoams Inc. and MuCell Extrusion LLC are incorporated in the USA.

The principal activities of the subsidiary undertakings are as follows: Zotefoams Inc. purchases, manufactures and distributes cross-linked block foams and Zotefoams International Limited is a holding company. MuCell Extrusion LLC holds and develops microcellular foam technology which it licenses to customers. 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.

The reporting date for MuCell Extrusion LLC is 30 June. The financial information included within these financial statements is based on management information as at 31 December.

# **Notes to the Financial Statements** continued

**12. Investments in subsidiaries** continued

**Deemed Acquisition of MuCell Extrusion LLC**

Zotefoams Inc owns 30% of the units in MuCell Extrusion LLC, whose principal place of business is Massachusetts, USA, with an option to increase its unit holding to 100%. The earliest this option could be exercised was 1 July 2010 but it may be exercised as late as June 2011. As Zotefoams plc can take ownership of the Company by exercising this option it is deemed to have a controlling interest under IFRS 3 (revised) and therefore from 1 July 2010 MuCell Extrusion LLC has been consolidated as a subsidiary.

Fair value of identifiable assets acquired and liabilities deemed acquired as at 1 July 2010:

| | £000 |
|---|---|
| Property, plant and equipment | 43 |
| Intangible assets | 3,988 |
| Inventories | 40 |
| Trade receivables | 263 |
| Other receivables and prepayments | 164 |
| Cash at bank | 332 |
| Trade and other payables | (207) |
| Total identifiable net assets | 4,623 |

The fair value of intangible assets has been determined by an independent valuation. These have been determined as follows:

Marketing related intangible assets

Those assets deemed acquired which are primarily used in the marketing or promotion of products and services. This includes the following assets (or right to use the following assets): trademarks, trade names, service marks, collective marks, certification marks, unique trade dress and internet domain names. These were valued by means of the royalty savings (relief from royalty) method of the income approach. Employing this concept the marketing related intangible assets are valued on the basis of the incremental after tax savings accruing to the owner because they do not have to pay a royalty to someone else for its use. A 16% discount rate has been used to calculate an after tax present value. A useful economic life of 10 years has been used.

Customer related intangible assets

Those assets consisting of customer lists, order or production backlogs, customer contracts and relationships and non-contractual customer relationships. These have been valued by calculating the present value of income, using a 16% discount rate, attributable to relationships with customers of the Company across the equipment and engineering business of MuCell Extrusion LLC. A useful economic life of six years has been used.

Technology related intangible assets

Those assets deemed acquired relating to innovations or technological advances. Such assets include computer software, patented and unpatented technology, databases and trade secrets. These have been valued using an income approach by calculating a present value using a 14% discount rate on the after tax cash flow derived from the licensing activity of MuCell Extrusion LLC. A useful economic life of 17 years has been used.

Goodwill

Goodwill was recognised as a result of the deemed acquisition as follows:

| | £000 |
|---|---|
| Assumed consideration | |
| Price originally paid ($3.00m) at 1 July 2010 exchange rate | 1,992 |
| Assumed purchase price for remaining 70% shareholding | 6,226 |
| Total assumed consideration | 8,218 |
| Fair value of identifiable net assets | (4,623) |
| Goodwill | 3,595 |

The re-measurement to fair value on 1 July 2010 of the Group's existing 30% interest in MEL resulted in a gain of £650,000. This together with £448,000 of exchange movements on the associate interest which had previously been taken to translation reserves and are transferred to the Income Statement on the deemed disposal of the associate interest have been recognised in profit before tax in the Statement of Comprehensive Income as an exceptional item.

The goodwill is attributable mainly to non-contractual or non-separable assets such as market share which are difficult to measure, the value of the identified intangible assets beyond their assumed useful life for amortisation purposes, the skills and technical talent of MEL's work force and the synergies expected to be achieved from integrating the Company into the Group's existing foam business. Following the deemed acquisition, only the amount equal to the original contribution of $3.00m is expected to be deductible for tax purposes.

The valuation of the goodwill, intangible and tangible assets of MuCell Extrusion LLC is provisional. These assets and liabilities need to be re-measured when Zotefoams decides whether to exercise the option to acquire the remaining 70% shareholding in MuCell Extrusion LLC that it does not own during 2011 or allow the option to lapse.

## 12. Investments in subsidiaries continued

### Non-controlling interest

The non-controlling interest has been calculated as 70% of the income and fair value of the net assets of MuCell Extrusion LLC reflecting the share ownership percentage of the Company which Zotefoams does not own.

### Summary aggregated financial information on MuCell Extrusion LLC

The summary aggregated income statements for MuCell Extrusion LLC for the six months ending 31 December 2010 (the period for which MEL has been consolidated) together with that for the year ending 31 December 2010 are as follows:

For the period:

| 100% of MuCell Extrusion LLC | 6 months ended 31 December 2010 £000 | 12 months ended 31 December 2010 £000 |
|---|---|---|
| Revenue | 610 | 1,527 |
| Amortisation | (124) | (235) |
| Loss/(gain) after amortisation | (32) | 261 |

### Impact of deemed acquisition on Group income statement

If the deemed acquisition of MEL had occurred on 1 January 2010 the impact on the Group Income Statement excluding exceptional items would have been as follows:

| | Including MEL as a subsidiary for the full year ended 31 December 2010 £000 | As reported: year ended 31 December 2010 £000 |
|---|---|---|
| Revenue | 40,796 | 39,879 |
| Operating profit | 5,128 | 4,826 |
| Financial income | 1,116 | 1,116 |
| Finance costs | (1,329) | (1,329) |
| Share of profit from associate | – | 88 |
| Profit before tax | 4,915 | 4,701 |
| Taxation | (995) | (995) |
| Profit for the year | 3,920 | 3,706 |
| Non-controlling interest | (171) | 23 |
| Profit attributable to equity holders of the parent | 3,749 | 3,729 |

## 13. Investments in associates

Zotefoams owns 30% of the share capital of MuCell Extrusion LLC. All the share capital of MuCell Extrusion LLC is denominated in units of the same class. MuCell Extrusion LLC therefore has been treated as an associate company up to 30 June 2010. At 1 July 2010 until 30 June 2011 Zotefoams has an option to purchase the remaining 70% share holding it does not already own and this requires MuCell Extrusion LLC to be included in Zotefoams' consolidated accounts under IFRS3 (revised).

### Summary aggregated financial information on associates – 100%:

| At 31 December | 2010 £000 | 2009 £000 |
|---|---|---|
| Goodwill | – | 2,798 |
| Intangible assets | – | 2,129 |
| Tangible assets | – | 31 |
| Current assets | – | 288 |
| Cash | – | 268 |
| Total assets | – | 5,514 |
| Total liabilities | – | (121) |
| Net assets | – | 5,393 |

# **Notes to the Financial Statements** continued

### **13. Investments in associates** continued

For the period:

| | **6 months ended 30 June 2010 £000** | 12 months ended 31 December 2009 £000 |
|---|---|---|
| Revenue | **917** | 1,651 |
| Amortisation | **(111)** | (217) |
| Gain after amortisation | **293** | 330 |

**Reconciliation of movement in MuCell Extrusion LLC valuation:**

| | **2010 £000** | 2009 £000 |
|---|---|---|
| Initial cost of investment including expenses | | |
| Cost brought forward as at 1 January | **1,687** | 1,912 |
| Share of result for period | **88** | 99 |
| Distribution received | **(82)** | (104) |
| Effect of movement in foreign exchange | **123** | (220) |
| Deemed disposal of associate interest | **(1,816)** | — |
| Investment in associate as at 31 December | **—** | 1,687 |

### **14. Inventories**

| | Group | | Company | |
|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Raw materials and consumables | **1,978** | 1,775 | **1,568** | 1,612 |
| Work in progress | **762** | 1,021 | **758** | 998 |
| Finished goods | **1,394** | 1,586 | **846** | 945 |
| | **4,134** | 4,382 | **3,172** | 3,555 |

The carrying amount of inventories subject to retention of title clauses is £174,000 (2009: £293,000).

In 2010 the value of inventory recognised by the Group as an expense in cost of goods sold was £25,149,000 (2009: £17,499,000).

### **15. Trade and other receivables**

| | | Group | | Company | |
|---|---|---|---|---|---|
| | Note | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Amounts falling due within one year: | | | | | |
| Trade receivables | | **8,846** | 7,196 | **7,118** | 5,699 |
| Fair value derivatives | 21 | **39** | 75 | **39** | 75 |
| Amounts owed by Group undertakings | 25 | **—** | — | **1,329** | 1,752 |
| Other receivables | | **268** | 200 | **268** | 200 |
| Prepayments and accrued income | | **310** | 258 | **235** | 243 |
| | | **9,463** | 7,729 | **8,989** | 7,969 |
| Trade receivables are shown net of: impairment losses | | **166** | 155 | **137** | 116 |

### **16. Cash and cash equivalents/bank overdrafts**

| | Group | | Company | |
|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Cash and cash equivalents per balance sheet | **4,716** | 2,975 | **3,998** | 2,718 |
| Bank overdrafts | **(711)** | (611) | **(711)** | (611) |
| Cash and equivalents per cash flow statements | **4,005** | 2,364 | **3,287** | 2,107 |

## 17. Trade and other payables

| | Note | Group 2010 £000 | Group 2009 £000 | Company 2010 £000 | Company 2009 £000 |
|---|---|---|---|---|---|
| Trade payables | | **1,554** | 1,204 | **1,480** | 1,147 |
| Other creditors including taxation and social security: | | | | | |
| Other taxation and social security | | **221** | 191 | **212** | 190 |
| Fair value derivatives | 21 | **108** | 111 | **108** | 111 |
| Amounts owed to Group undertakings | | **—** | — | **—** | 4 |
| Other payables | | **491** | 432 | **384** | 367 |
| Accruals and deferred income | | **2,615** | 2,194 | **2,375** | 2,137 |
| | | **4,989** | 4,132 | **4,559** | 3,956 |

## 18. Interest-bearing loans and borrowings

| | Note | Group 2010 £000 | Group 2009 £000 | Company 2010 £000 | Company 2009 £000 |
|---|---|---|---|---|---|
| Bank Loans | | **660** | 660 | **660** | 660 |
| Amounts due to Group undertakings | 25 | **—** | — | **3,375** | 2,848 |
| Amounts falling due within one year | | **660** | 660 | **4,035** | 3,508 |
| Bank loans | | **1,488** | 2,134 | **1,488** | 2,134 |
| Amounts falling due in more than one year | | **1,488** | 2,134 | **1,488** | 2,134 |
| | 21 | **2,148** | 2,794 | **5,523** | 5,642 |

## 19. Deferred tax assets and liabilities

**Recognised deferred tax assets and liabilities – Group**

Deferred tax assets and liabilities are attributable to the following:

| | Assets 2010 £000 | Assets 2009 £000 | Liabilities 2010 £000 | Liabilities 2009 £000 | Net 2010 £000 | Net 2009 £000 |
|---|---|---|---|---|---|---|
| Property, plant and equipment | **—** | — | **2,050** | 2,285 | **2,050** | 2,285 |
| Rolled-over gain | **—** | — | **902** | 902 | **902** | 902 |
| Inventories | **(91)** | (92) | **—** | — | **(91)** | (92) |
| Financial instruments | **(19)** | (10) | **—** | — | **(19)** | (10) |
| Employee benefits | **(1,616)** | (1,800) | **—** | — | **(1,616)** | (1,800) |
| Tax value of recognised losses carried forward | **(261)** | (157) | **—** | — | **(261)** | (157) |
| Tax (assets)/liabilities | **(1,987)** | (2,059) | **2,952** | 3,187 | **965** | 1,128 |
| Set off tax | **1,635** | 1,810 | **(1,635)** | (1,810) | **—** | — |
| Net tax (assets)/liabilities | **(352)** | (249) | **1,317** | 1,377 | **965** | 1,128 |

At 31 December 2010 a deductible temporary difference of £1,041,000 (2009: £1,635,000) relating to undistributed reserves in a subsidiary has not been recognised because the Group controls whether the liability will be incurred and is satisfied that it will not be incurred in the foreseeable future.

The Emergency Budget announced a phased reduction in the main UK corporation tax rate from 28% to 24%, with the first 1% reduction taking effect from 1 April 2011 (and substantively enacted on 20 July 2010). The Budget also set out various other proposed corporation tax changes, including changes in capital allowance rates.

IAS 12.47 requires that deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on rates that have been enacted or substantively enacted by the balance sheet date. Therefore, in preparing the financial statements, UK deferred tax assets and liabilities have been calculated based on a rate of 27%, where the temporary difference is expected to reverse after 1 April 2011.

No account will be taken of the expected further 3% reduction in tax rates until substantive enactment of these changes. These changes are expected to lead to a reduction in deferred tax assets and liabilities.

**Unrecognised deferred tax assets**

The Group has $4.5m of tax losses carried forward in the USA. These tax losses at a 35% tax rate and year end exchange rates have a value of £1.0m. The Group has only recognised £261,000 of these tax losses as a deferred tax asset representing what the Board believe is a reasonable estimate of the expected US tax utilisation in the near future.

# **Notes to the Financial Statements** continued

## **19. Deferred tax assets and liabilities** continued

### Movement in deferred tax during the year

| | Balance 1 January 2010 £000 | Recognised in income £000 | Recognised in equity £000 | **Balance 31 December 2010 £000** |
|---|---|---|---|---|
| Property, plant and equipment | 2,285 | (235) | — | **2,050** |
| Rolled-over gain | 902 | — | — | **902** |
| Inventories | (92) | 1 | — | **(91)** |
| Financial instruments | (10) | — | (9) | **(19)** |
| Employee benefits | (1,800) | 185 | (1) | **(1,616)** |
| Tax value of recognised losses carried forward | (157) | (104) | — | **(261)** |
| | 1,128 | (153) | (10) | **965** |

### Movement in deferred tax during the prior year

| | Balance 1 January 2009 £000 | Recognised in income £000 | Recognised in equity £000 | Balance 31 December 2009 £000 |
|---|---|---|---|---|
| Property, plant and equipment | 2,432 | (147) | — | 2,285 |
| Rolled-over gain | 902 | — | — | 902 |
| Inventories | (92) | — | — | (92) |
| Financial instruments | (354) | — | 344 | (10) |
| Employee benefits | (1,011) | 7 | (796) | (1,800) |
| Tax value of recognised losses carried forward | (147) | (10) | — | (157) |
| | 1,730 | (150) | (452) | 1,128 |

### Deferred tax assets and liabilities – Company

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Property, plant and equipment | **—** | — | **2,050** | 2,285 | **2,050** | 2,285 |
| Rolled-over gain | **—** | — | **902** | 902 | **902** | 902 |
| Financial instruments | **(19)** | (10) | **—** | — | **(19)** | (10) |
| Employee benefits | **(1,616)** | (1,800) | **—** | — | **(1,616)** | (1,800) |
| Tax (assets)/liabilities | **(1,635)** | (1,810) | **2,952** | 3,187 | **1,317** | 1,377 |
| Set off tax | **1,635** | 1,810 | **(1,635)** | (1,810) | **—** | — |
| Net tax liabilities | **—** | — | **1,317** | 1,377 | **1,317** | 1,377 |

### Movement in deferred tax during the year

| | Balance 1 January 2010 £000 | Recognised in income £000 | Recognised in equity £000 | **Balance 31 December 2010 £000** |
|---|---|---|---|---|
| Property, plant and equipment | 2,285 | (235) | — | **2,050** |
| Rolled-over gain | 902 | — | — | **902** |
| Financial instruments | (10) | — | (9) | **(19)** |
| Employee benefits | (1,800) | 185 | (1) | **(1,616)** |
| | 1,377 | (50) | (10) | **1,317** |

### Movement in deferred tax during the prior year

| | Balance 1 January 2009 £000 | Recognised in income £000 | Recognised in equity £000 | Balance 31 December 2009 £000 |
|---|---|---|---|---|
| Property, plant and equipment | 2,432 | (147) | — | 2,285 |
| Rolled-over gain | 902 | — | — | 902 |
| Financial instruments | (354) | — | 344 | (10) |
| Employee benefits | (1,011) | 7 | (796) | (1,800) |
| | 1,969 | (140) | (452) | 1,377 |

## 20. Share capital

| | **2010** **£** | 2009 £ |
|---|---|---|
| Authorised<br>At 31 December | | |
| Equity: 56,000,000 ordinary shares of 5.0p each | **not applicable** | 2,800,000 |
| Allotted, called-up and fully paid<br>At 31 December | | |
| Equity: 38,297,093 (2009: 38,297,093) ordinary shares of 5.0p each | **1,914,855** | 1,914,855 |

The requirement for the Company to have an authorised share capital was abolished with the passing of a resolution to that effect adopting new articles of association in accordance with the Companies Act 2006 at the Annual General Meeting on 11 May 2010.

Details of share options are provided in note 24 to the accounts on page 68.

During 2009 the Company issued 516,387 ordinary shares to the Employee Benefit Trust. No shares were issued in 2010.

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

## 21. Financial instruments

### Policy

The Group's principal financial instruments include bank loans, cash and short-term deposits the main purpose of which is to raise finance for the Group's operations. Foreign exchange derivatives are used to help manage the Group's currency exposure. It is and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are credit risk, interest rate risk, liquidity risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised overleaf. These policies have remained fundamentally unchanged throughout the year.

### Credit risk

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

In 2010 and 2009, the Group had credit insurance to mitigate this risk. However, the uninsured exposure as at 31 December 2010 was £1,844,000 (2009: £1,285,000) so elements of risk remain.

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

Trade receivables can be analysed as follows:

| | **Group 2010 £000** | Group 2009 £000 |
|---|---|---|
| Amounts neither past due or impaired | **7,129** | 5,672 |
| Amounts past due but not impaired | | |
| Less than 60 days | **1,287** | 1,200 |
| More than 60 days | **—** | — |
| Total past due but not impaired | **1,287** | 1,200 |
| Amounts impaired | **596** | 479 |
| Impairment allowance | **(166)** | (155) |
| Carrying amount of impaired receivables | **430** | 324 |
| Trade Receivables net of allowances | **8,846** | 7,196 |

# **Notes to the Financial Statements** continued

**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's borrowings at 31 December was:

| | **2010** | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Effective interest rate** | **Fixed rates £000** | **Variable rates £000** | **Total £000** | Effective interest rate | Fixed rates £000 | Variable rates £000 | Total £000 |
| Sterling | **2%** | **—** | **2,859** | **2,859** | 2% | — | 3,405 | 3,405 |
| | | | **2,859** | **2,859** | | | 3,405 | 3,405 |

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

**Liquidity risk**

The Group's objective is to maintain a balance of continuity of funding and flexibility through the use of overdrafts, loans and finance leases as applicable. The maturity profile of the Group's borrowings is shown in note 18 on page 61.

The Group has a short-term facility of £4.9m which is freely transferable and convertible into sterling. This facility is repayable on demand and is utilised by Zotefoams plc and its subsidiary undertakings under a cross-guarantee structure.

In January 2009 Zotefoams plc borrowed £3.3m under a five-year mortgage, repayable in equal quarterly instalments. This facility is secured over specific plant assets. At 31 December 2010 £2.1m of this mortgage was outstanding and £1.2m had been repaid.

Cash flow forecasts are produced to monitor the expected cash flow requirements of the Group against the available facilities.

**Foreign currency risk**

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

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

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Average** | **Closing** | Average | Closing |
| Euro/sterling | **1.17** | **1.17** | 1.12 | 1.13 |
| US dollar/sterling | **1.55** | **1.57** | 1.57 | 1.61 |

The Group hedges a proportion of its estimated cash exposure in respect of trade and other receivables, trade and other payables and forecast sales receipts and purchase payments for the next nine months. The Group uses forward exchange contracts to hedge its foreign currency risk. As at 31 December 2010 these forward currency contracts covered approximately two-thirds of the estimated net cash foreign exchange exposure for the next nine months. Further details are shown below in the paragraph on sensitivity analysis.

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

**Forecasted transactions**

The Group classifies its forward exchange contracts hedging forecasted transactions as cash flow hedges and states them at fair value. The net fair value of forward exchange contracts used as hedges of forecasted transactions at 31 December 2010 was a net liability of £69,000 (2009: net liability of £36,000) comprising assets of £39,000 (2009: £75,000) and liabilities of £108,000 (2009: £111,000) that were recognised in fair value derivatives in 2010.

**Recognised assets and liabilities**

Changes in the fair value of forward exchange contracts that economically hedge monetary assets and liabilities in foreign currencies and for which no hedge accounting is applied are recognised in the Income Statement. Both the changes in fair value of the forward contracts and the foreign exchange gains and losses relating to the monetary items are recognised as part of administrative expenses (see Note 3).
The maturity profile of the forward contracts as at 31 December is as follows:

| | **Group 2010** | | | Group 2009 | | |
|---|---|---|---|---|---|---|
| | **Foreign Currency '000** | **Contract Value £000** | **Fair Value £000** | Foreign Currency '000 | Contract Value £000 | Fair Value £000 |
| Sell EUR | **€4,400** | **3,731** | **3,801** | €5,000 | 4,411 | 4,454 |
| Sell USD | **$5,100** | **3,299** | **3,298** | $4,700 | 2,911 | 2,905 |

**21. Financial instruments** continued

**Sensitivity analysis**

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

Short-term fluctuations in interest rates are not hedged as the Group, at present, does not consider them material. At 31 December 2010 it is estimated that a general increase of one percentage point in interest rates would decrease the Group's profit before tax by approximately £28,000 (2009: £28,000).

At 31 December 2010 it is estimated that an increase of one percentage point in the value of sterling against the euro and US dollar would decrease the Group's profit before tax by approximately £88,000 (2009: £85,000) before forward exchange contracts and £50,000 (2009: £39,000) after forward exchange contracts are included for the euro and £77,000 (2009: £58,000) for the US dollar before forward exchange contracts and £44,000 (2009: £28,000) after forward exchange contracts are included.

The Group has significant undertakings in the USA whose revenue and expenses are denominated in US dollars. It also makes a significant proportion of its sales to European customers and these revenues are predominantly in euros. It was the Group's policy in 2010 to hedge the foreign currency cash flows of invoiced sales net of expected foreign currency expenditure. Hedging is achieved by the use of foreign currency contracts expiring in the month of expected cash flow.

**Fair values**

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

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Carrying amount £000** | **Fair value £000** | Carrying amount £000 | Fair value £000 |
| Trade and other receivables | **8,807** | **8,807** | 7,654 | 7,654 |
| Cash and cash equivalents | **4,005** | **4,005** | 2,364 | 2,364 |
| Forward exchange contracts – assets | **39** | **39** | 75 | 75 |
| – liabilities | **(108)** | **(108)** | (111) | (111) |
| Secured bank loans | **(2,148)** | **(2,156)** | (2,794) | (2,805) |
| Trade and other payables | **(4,881)** | **(4,881)** | (4,021) | (4,021) |

**Estimation of fair values**

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

a. Derivatives

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

b. Interest-bearing loans and borrowings and trade and other receivables/payables

Carrying amounts equals the fair value less loan arrangement fee of £8,000 (2009: £11,000).

**Capital management**

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board of Directors monitors the return on capital which the Group defines as profit before tax excluding divided by average net assets. Goodwill, intangible assets and any associated amortisation are excluded from this calculation. The Board of Directors also monitors the level of dividends paid to ordinary shareholders.

**22. Commitments**

| | **2010 £000** | 2009 £000 |
|---|---|---|
| (i) Capital contracts at the end of the financial year for which no provision has been made | **404** | 396 |
| (ii) The Group has non-cancellable operating lease rentals, which are payable as follows: | | |
| – within one year | **92** | 72 |
| – between two and five years | **57** | 108 |

During the year ended 31 December 2010 £93,000 was recognised as an expense in the Income Statement in respect of operating leases (2009: £87,000).

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

# **Notes to the Financial Statements** continued

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

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

Contributions to the plan for the year from the Company were £55,000 per month, a rate agreed with the Company and the Trustees following the triennial review in April 2008 to apply from January 2009 until June 2016.

The Company has opted to recognise all actuarial gains and losses immediately in Other Comprehensive Income. An actuarial valuation of the scheme was carried out as at 5 April 2008 and the results have been updated to 31 December 2010 by a qualified independent actuary. The major assumptions used by the actuary were (in nominal terms) as follows:

| | **As at 31 December 2010** | As at 31 December 2009 | As at 31 December 2008 |
|---|---|---|---|
| Discount rate | **5.30%** | 5.70% | 6.30% |
| Expected return on plan assets | **6.21%** | 6.72% | 5.76% |
| Rate of salary increase | **n/a** | n/a | n/a |
| Rate of increase to pensions in payment | **3.70%** | 3.90% | 3.00% |
| Rate of inflation | **3.20%** | 3.70% | 3.10% |
| Mortality assumption | **PCA00 MC** | PCA00 MC | PCA00 MC |
| Life expectancy from age 65 of current male pensioners | **21.7 years** | 21.7 years | 21.6 years |
| Commutation assumption | **75% of members take maximum cash** | 75% of members take maximum cash | 75% of members take maximum cash |

The mortality tables used above are those published by the Institute and Faculty of Actuaries, with allowance for improvements in member longevity in line with 'Medium Cohort' projections, based on members' year of birth. These adjusted rates suggest that a man aged 65 retiring at 31 December 2010 could expect to live, on average, until age 87. A 5% change in life expectancy from the age of 65 would increase/decrease the pension scheme's IAS 19 liability by approximately £0.6m (£0.4m after deferred tax), all other things being equal.

The overall expected return on assets assumption of 6.21% as at 31 December 2010 has been derived by calculating the weighted average of the expected rate of return for each asset class. The following approach has been used to determine the expected rate of return for each asset class:
- Equities – allowance for an additional return of 3.25% above that available on UK government securities;
- Fixed interest securities – current market yields
- Cash – based on the Bank of England base rate.

## 23. Employee benefits continued

**Present value of scheme assets:**

| | **Year ended 31 December 2010** | | Year ended 31 December 2009 | | Year ended 31 December 2008 | |
|---|---|---|---|---|---|---|
| | **Long Term rate of return expected** | **Market value £000** | Long Term rate of return expected | Market value £000 | Long Term rate of return expected | Market value £000 |
| Equities | **7.3%** | **13,624** | 7.8% | 12,069 | 7.0% | 9,298 |
| Bonds | **4.0%** | **3,262** | 4.5% | 3,443 | 3.8% | 3,154 |
| Other | **0.5%** | **1,198** | 0.5% | 750 | 2.0% | 1,417 |
| Insured pensioners | | **172** | | 166 | | — |
| | | **18,256** | | 16,428 | | 13,869 |

**Present value of defined obligation:**

| | | |
|---|---|---|
| Funded plans | **23,215** | 22,211 |
| Total | **23,215** | 22,211 |
| Deficit in the scheme | **(4,959)** | (5,783) |
| Related deferred tax asset | **1,389** | 1,619 |
| Net pension liability | **(3,570)** | (4,164) |

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

| | | |
|---|---|---|
| Benefit obligation at beginning of year | **22,211** | 17,396 |
| Interest cost | **1,244** | 1,065 |
| Actuarial losses | **529** | 4,538 |
| Benefits and expenses paid | **(769)** | (983) |
| Past service costs | **–** | 29 |
| Inclusion of reserve for insured pensioners as at 31 December | **–** | 166 |
| Benefit obligation at end of year | **23,215** | 22,211 |

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

| | | |
|---|---|---|
| Fair value of plan assets at beginning of year | **16,428** | 13,869 |
| Expected return on plan assets | **1,100** | 792 |
| Actuarial gains | **837** | 1,840 |
| Contributions by employer | **660** | 744 |
| Benefits and expenses paid | **(769)** | (983) |
| Inclusion of reserve for insured pensioners as at 31 December | **–** | 166 |
| Fair value of plan assets at end of year | **18,256** | 16,428 |

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

| | | |
|---|---|---|
| Interest on obligation | **1,244** | 1,065 |
| Expected return on plan assets | **(1,100)** | (792) |
| Past service cost | **–** | 29 |
| Total expense | **144** | 302 |

# **Notes to the Financial Statements** continued

## **23. Employee benefits** continued

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

| | Group and Company | |
|---|---|---|
| | **2010 £000** | 2009 £000 |
| Cost of sales | **–** | 29 |
| Financial income | **(1,100)** | (792) |
| Finance costs | **1,244** | 1,065 |
| | **144** | 302 |

**Actuarial gains/(losses) shown in Other Comprehensive Income since 1 January 2006:**

| | **2010 £000** | 2009 £000 | 2008 £000 | 2007 £000 | 2006 £000 |
|---|---|---|---|---|---|
| Balance as at 1 January | **(2,567)** | 131 | 1,789 | 648 | 222 |
| Actuarial gains/(losses) | **308** | (2,698) | (1,658) | 1,141 | 426 |
| Balance as at 31 December | **(2,259)** | (2,567) | 131 | 1,789 | 648 |

**History of scheme assets, obligations and experience adjustments**

| | **As at 31 December 2010 £000** | As at 31 December 2009 £000 | As at 31 December 2008 £000 | As at 31 December 2007 £000 | As at 31 December 2006 £000 |
|---|---|---|---|---|---|
| Present value of defined benefit obligation | **23,215** | 22,211 | 17,396 | 19,707 | 20,101 |
| Fair value of scheme assets | **18,256** | 16,428 | 13,869 | 17,242 | 15,861 |
| Deficit in the scheme | **(4,959)** | (5,783) | (3,527) | (2,465) | (4,240) |
| Experience adjustments arising on scheme liabilities | **529** | 4,538 | (2,752) | (875) | 233 |
| Experience item as a percentage of scheme liabilities | **2%** | 20% | (16)% | (4)% | 1% |
| Experience adjustments arising on scheme assets | **837** | 1,840 | (4,410) | 266 | 659 |
| Experience item as a percentage of scheme assets | **5%** | 11% | (32)% | 2% | 4% |

**Other pension schemes**

On 1 January 2006 a separate stakeholder scheme was set up for those employees who were originally in the closed defined benefit scheme. The contributions paid by the Company in 2010 were £404,000 (2009: £450,000).

In addition to this scheme, Zotefoams plc operates a stakeholder scheme which is open to employees who joined after 1 October 2001. The contributions paid by the Company in 2010 were £96,000 (2009: £80,000).

For US based employees Zotefoams Inc. operates a 401(k) plan. MuCell Extrusion LLC does not operate a pension plan. The contributions paid by Zotefoams Inc. in 2010 were $76,000 (2009: $73,000).

## **24. Share-based payments**

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

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

In 2007 the Company also introduced a deferred bonus plan. Executive bonuses over 40% of salary are held as deferred shares for three years. Depending on the circumstances awards are normally forfeited if the employee leaves the Group before the award vests.

For 2009 only the Company replaced the Executive Bonus Scheme with a share-based bonus plan. Shares were awarded in March 2010 based on performance against set objectives.

Details of the vesting conditions for the share, share option and LTIP awards are given in the Directors' Remuneration Report on page 27.

**24. Share-based payments** continued

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

| | **2010** Number of share options | **2010** Weighted average exercise price (p) | 2009 Number of share options | 2009 Weighted average exercise price (p) |
|---|---|---|---|---|
| Outstanding at beginning of the period | **1,090,091** | **83.3** | 1,104,958 | 83.6 |
| Forfeited during the period | **nil** | **—** | (7,639) | 106.7 |
| Cancelled during the period | **(3,046)** | **106.7** | (7,228) | 106.7 |
| Exercised during the period | **(564,105)** | **76.3** | nil | — |
| Granted during the period | **47,367** | **95.0** | nil | — |
| Outstanding at the end of the period | **570,307** | **91.0** | 1,090,091 | 83.3 |
| Exercisable at the end of the period | **272,942** | **76.0** | 837,047 | 76.2 |

The options outstanding at 31 December 2010 have an exercise price of between 72.5p and 106.7p and a weighted contractual life of nine years.

The fair value received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of fair value of the services received measured is based on a Black-Scholes model. The contractual life of the option (ten years) is used as an input into this model. No allowance is made for early leavers.

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

| | **2010** Number of share options | **2010** Weighted average exercise price (p) | 2009 Number of share options | 2009 Weighted average exercise price (p) |
|---|---|---|---|---|
| Outstanding at beginning of the period | **715,038** | **—** | 505,610 | — |
| Granted during the period | **237,805** | **—** | 516,387 | — |
| Cancelled during the period | **(97,891)** | **—** | — | — |
| Lapsed during the period | **(79,152)** | **—** | (306,959) | — |
| Outstanding at the end of the period | **775,800** | **—** | 715,038 | — |
| Exercisable at the end of the period | **—** | **—** | — | — |

**Details of the Deferred Bonus Plan awards outstanding during the year are as follows:**

| | **2010** Number of share options | **2010** Weighted average exercise price (p) | 2009 Number of share options | 2009 Weighted average exercise price (p) |
|---|---|---|---|---|
| Outstanding at beginning of the period | **61,818** | **—** | 34,632 | — |
| Exercised in the period | **(4,681)** | **—** | (2,979) | — |
| Granted during the period | **—** | **—** | 30,165 | — |
| Outstanding at the end of the period | **57,137** | **—** | 61,818 | — |
| Exercisable at the end of the period | **—** | **—** | — | — |

**Details of the 2009 Share Bonus Plan awards outstanding at the end of the year are as follows:**

| | **2010** Number of share options | **2010** Weighted average exercise price (p) | 2009 Number of share options | 2009 Weighted average exercise price (p) |
|---|---|---|---|---|
| Outstanding at beginning of the period | **217,775** | **—** | — | — |
| Exercised in the period | **(217,775)** | **—** | — | — |
| Granted during the period | **—** | **—** | 217,775 | — |
| Outstanding at the end of the period | **—** | **—** | 217,775 | — |
| Exercisable at the end of the period | **—** | **—** | nil | — |

# **Notes to the Financial Statements** continued

### **24. Share-based payments** continued

**Fair value of share options and assumptions**

The expected volatility is based on historic volatility for a three year period prior to the award.

| | 20 March 2008 | 12 August 2008 | 16 March 2009 | 7 May 2009 | **19 March 2010** | **19 March 2010** |
|---|---|---|---|---|---|---|
| Share price (p) | 98.7 | 106.7 | 46.0 | 60.5 | **99.0** | **95.0** |
| Exercise price (p) | nil | 106.7 | nil | nil | **nil** | **95.0** |
| Expected volatility | 30% | 30% | 30% | 30% | **35%** | **35%** |
| Option life | Five years | Five years | Five years | Five years | **Five years** | **Five years** |
| Expected dividends (p) (assumed to be increasing at 2.5% pa) | nil | 4.5 | nil | nil | **nil** | **4.5** |
| Risk-free interest rate (based on national government bonds) | 4.7% | 4.6% | 4.8% | 4.8% | **1.3%** | **1.3%** |
| Fair value at grant date (p) | 98.7 | 23.3 | 46.0 | 60.5 | **99.0** | **19.0** |

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

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

| | Group and Company | |
|---|---|---|
| | **2010 £000** | 2009 £000 |
| Within administrative expenses | **206** | 260 |
| Element of the above relating to Directors of Zotefoams plc | **110** | 128 |

### **25. Related parties**

**Directors**

The Directors of the Company as at 31 December 2010 and their immediate relatives control 1.0% of the voting shares of the Company. Details of Directors' pay and remuneration are given in the Directors' Remuneration Report on page 24. The Directors are considered to be the only key management personnel.

**Subsidiaries**

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

Zotefoams Inc. owns 30% of the ownership units of MuCell Extrusion LLC. From 1 July 2010 Zotefoams has an option to purchase MuCell Extrusion LLC and is deemed to have a controlling interest under IFRS3 (revised). From 1 July 2010 MuCell Extrusion LLC has therefore been treated as a subsidiary company.

Transactions between Zotefoams plc and these subsidiaries are as follows:

**Income Statement**

| | Sales to | | Service fees to | | Interest charged to | | Interest charged from | |
|---|---|---|---|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| MuCell Extrusion LLC | **—** | — | **26** | — | **—** | — | **—** | — |
| Zotefoams Inc. | **5,298** | 4,601 | **74** | 72 | **95** | 94 | **68** | 44 |

The above transactions with MuCell Extrusion LLC are for the six months ending 31 December 2010.

**Balance Sheet**

| | Loan owed to | | Loan owed by | | Payables owed to | | Receivables owed by | | Investment in | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 | **2010 £000** | 2009 £000 |
| Zotefoams Inc.[1] | **3,375** | 2,848 | **4,151** | 4,025 | **—** | 4 | **1,329** | 1,752 | **—** | **—** |
| Zotefoams International | **—** | — | **—** | — | **—** | — | **—** | — | **3,863** | **3,863** |

1 Loans with Zotefoams Inc. are interest bearing.

**25. Related parties** continued

**Associates**

Zotefoams Inc. owns 30% of the shares of MuCell Extrusion LLC. Prior to 1 July 2010 MuCell Extrusions LLC has been treated as an associate company. Transactions between Zotefoams plc and its subsidiaries and this associate are as follows:

| | | Recharges of costs incurred by Zotefoams plc | | Distribution received by Zotefoams Inc. | |
|---|---|---|---|---|---|
| | Note | **Six months ending 30 June 2010 £000** | Year ending 31 December 2009 £000 | **Six months ending 30 June 2010 £000** | Year ending 31 December 2009 £000 |
| Income Statement | | **38** | 40 | **—** | — |
| Balance Sheet | 13 | **—** | — | **(82)** | (104) |

In addition to the above Zotefoams plc bought £12,000 of capital equipment from MuCell Extrusion LLC in the first half of 2010.

**26. Accounting estimates and judgements**

In the application of the Groups accounting policies, which are described in note 1, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities which are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other facts that are considered relevant. Actual amounts may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision only affects that period, or in the period of the revision and future periods if the revision affects both current and future periods.

**Key sources of estimation uncertainty**

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are disclosed below.

i) Foreign exchange

Group hedging policy is to defer the impact of profits of currency movements by hedging a proportion of projected transaction exposure. Forward exchange contracts are used to manage the exposure to fluctuations in foreign exchange rates. These forward contracts are entered into on the basis of forecasts of future trading and the valuation of these contracts is calculated using forward exchange rates.

ii) Share-based payment transactions

The charge for share-based payment transactions is calculated in accordance with Group policy. The option valuation models used require subjective assumptions to be made including the future volatility of the Company's share price, expected dividend yields, risk-free interest rates and expected staff turnover. Note 24 contains information about assumptions relating to share-based payments.

iii) Property, plant and equipment

In relation to the Group's property, plant and equipment, useful economic lives and residual values of assets have been established using historical experiences and an assessment of the nature of the assets involved. Assets are assessed on an ongoing basis to determine whether circumstances exist that could lead to a potential impairment of the carrying value of such assets. No circumstances have been identified to suggest that this is the case.

iv) Intangible assets

The determination of goodwill and intangible assets requires judgements made by the Directors. Goodwill is reviewed annually to assess the requirement for impairment. Other intangible assets are assessed on an ongoing basis to determine whether circumstances exist that could lead to the conclusion that the carrying value of such assets is not supportable. Such calculations require judgement relating to the appropriate discount factors and long-term growth prevalent in particular markets as well as short-term business performance. The Directors also draw upon experience in making these judgements.

v) Development Costs

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

vi) Pensions assumptions

The valuation of pension scheme liabilities is calculated in accordance with Group policy. The valuation is prepared by an independent qualified actuary but significant judgements are required in relation to the assumptions for pension increases, inflation, the discount rate applied, investment returns and member longevity which underpin the valuations. Note 23 contains information about the assumptions relating to retirement benefit obligations.

# Notice of the 2011 Annual General Meeting

Notice is hereby given that the Annual General Meeting (the 'AGM') of Zotefoams plc (the 'Company') will be held at the registered office of the Company, 675 Mitcham Road, Croydon CR9 3AL on 12 May 2011 at 10.00 a.m. for the following purposes:

**Ordinary business**
To consider and, if thought fit, pass resolutions numbered 1 to 6 below as ordinary resolutions:

1. To receive the audited annual accounts of the Company for the year ended 31 December 2010, together with the Directors' Report, the Directors' Remuneration Report and the auditor's report on those annual accounts, the Directors' Report and that section of the remuneration report subject to audit.

2. To approve the Directors' Remuneration Report for the year ended 31 December 2010 in accordance with section 439 of the Companies Act 2006.

3. To declare a final dividend for the year ended 31 December 2010 of 3.15 pence per ordinary share, such dividend to be payable on 24 May 2010 to shareholders who are on the register of members of the Company at the close of business on 26 April 2010.

4. To re-elect R J Clowes as a Director who retires by rotation in accordance with the Company's articles of association.

5. To re-elect R H Lawson as a Director who retires by rotation in accordance with the Company's articles of association.

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

**Special business**
To consider and, if thought fit, to pass the following resolutions of which resolution 7 will be proposed as an ordinary resolution and resolutions 8, 9 and 10 will be proposed as special resolutions:

7. That, in substitution for any equivalent authorities and powers granted to the Directors prior to the passing of this resolution, the Directors be and they are generally and unconditionally authorised pursuant to section 551 of the Companies Act 2006 (the 'Act'):

   (a) to exercise all powers of the Company to allot shares in the Company, and grant rights to subscribe for or to convert any security into shares in the Company (such shares, and rights to subscribe for or to convert any security into shares of the Company being 'relevant securities') up to an aggregate nominal amount of £638,285 (such amount to be reduced by the nominal amount of any allotments or grants made under paragraph (b) below in excess of £638,285); and further

   (b) to allot equity securities (as defined in section 560 of the Act) up to an aggregate nominal amount of £1,276,570 (such amount to be reduced by the nominal amount of any allotments or grants made under paragraph (a) above) in connection with an offer by way of rights issue:

      (i) in favour of holders of ordinary shares in the capital of the Company, where the equity securities respectively attributable to the interests of all such holders are proportionate (as nearly as practicable) to the respective number of ordinary shares in the capital of the Company held by them; and

      (ii) to holders of any other equity securities as required by the rights of those securities or as the Directors otherwise consider necessary,

   but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with treasury shares, fractional entitlements or legal, regulatory or practical problems arising under the laws or requirements of any overseas territory or by virtue of shares being represented by depository receipts or the requirements of any regulatory body or stock exchange or any other matter whatsoever; and

   (c) provided that, unless previously revoked, varied or extended, this authority shall expire on the earlier of the date falling 18 months after the date of the passing of this resolution and the conclusion of the next Annual General Meeting of the Company, except that the Company may at any time before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if this authority had not expired.

8. That the Directors be and they are empowered pursuant to section 570(1) of the Act to allot equity securities (as defined in section 560(1) of the Act) of the Company wholly for cash pursuant to the authority of the Directors under section 551 of the Act conferred by resolution 7 above, and/or by way of a sale of treasury shares for cash (by virtue of section 573 of the Act), in each case as if section 561(1) of the Act did not apply to such allotment provided that:

(a) the power conferred by this resolution shall be limited to:

(i) the allotment of equity securities and sale of treasury shares for cash in connection with an offer of, or invitation to apply for, equity securities (but in the case of the authority granted under paragraph (b) of resolution 7, by way of a rights issue only):

(A) in favour of holders of ordinary shares in the capital of the Company, where the equity securities respectively attributable to the interests of all such holders are proportionate (as nearly as practicable) to the respective number of ordinary shares in the capital of the Company held by them; and

(B) to holders of any other equity securities as required by the rights of those securities or as the Directors otherwise consider necessary,

but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with treasury shares, fractional entitlements or legal, regulatory or practical problems arising under the laws or requirements of any overseas territory or by virtue of shares being represented by depository receipts or the requirements of any regulatory body or stock exchange or any other matter whatsoever; and

(ii) in the case of the authority granted under paragraph (a) of resolution 7 and/or in the case of any sale of treasury shares for cash, the allotment, otherwise than pursuant to sub-paragraph (i) above, of equity securities or sale of treasury shares up to an aggregate nominal value equal to £95,742; and

(b) unless previously revoked, varied or extended, this power shall expire on the earlier of the date falling 18 months after the date of the passing of this resolution and the conclusion of the next Annual General Meeting of the Company except that the Company may before the expiry of this power make an offer or agreement which would or might require equity securities to be allotted (and treasury shares to be sold) after such expiry and the Directors may allot equity securities (and sell treasury shares) in pursuance of such an offer or agreement as if this power had not expired.

9. That the Company be and is hereby unconditionally and generally authorised for the purposes of section 701 of the Act to make market purchases (within the meaning of section 693(4) of the Act) of its ordinary shares of 5 pence each ('Ordinary Shares') provided that:

(a) the maximum number of Ordinary Shares authorised to be purchased is 3,829,709;

(b) the minimum price which may be paid for any such Ordinary Share is 5 pence;

(c) the maximum price which may be paid for an Ordinary Share shall be an amount equal to 105% of the average middle market quotations for an Ordinary Share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the Ordinary Share is contracted to be purchased; and

(d) this authority shall, unless previously renewed, revoked or varied, expire on the earlier of the date falling 18 months after the date of the passing of this resolution and the conclusion of the next Annual General Meeting, but the Company may enter into a contract for the purchase of Ordinary Shares before the expiry of this authority which would or might be completed (wholly or partly) after its expiry.

10. That a general meeting other than an annual general meeting may be called on not less than 14 clear days' notice.

By order of the Board

31 March 2011

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

**C G Hurst**
Company Secretary

**Notes**

(i) Pursuant to Part 13 of the Companies Act 2006 and to Regulation 41 of the Uncertificated Securities Regulations 2001 (as amended), only those members registered in the register of members of the Company at 10.00 a.m. on 10 May 2011 (or if the AGM is adjourned, 48 hours before the time fixed for the adjourned AGM) shall be entitled to attend and vote at the AGM in respect of the number of shares registered in their name at that time. In each case, changes to the register of members after such time shall be disregarded in determining the rights of any person to attend or vote at the AGM.

(ii) If you wish to attend the AGM in person please bring the accompanying attendance card and present this to the Company's reception desk on arrival.

(iii) A member who is entitled to attend, speak and vote at the AGM may appoint a proxy to attend, speak and vote instead of him. A member may appoint more than one proxy provided each proxy is appointed to exercise rights attached to different shares (so a member must have more than one share to be able to appoint more than one proxy). A proxy need not be a member of the Company but must attend the AGM in order to represent you. A proxy must vote in accordance with any instructions given by the member by whom the proxy is appointed. Appointing a proxy will not prevent a member from attending in person and voting at the AGM (although voting in person at the AGM will terminate the proxy appointment). A proxy form is enclosed. The notes to the proxy form include instructions on how to appoint the Chairman of the AGM or another person as a proxy. You can only appoint a proxy using the procedures set out in these Notes and in the notes to the proxy form.

# **Notice of the 2011 Annual General Meeting** continued

(iv) To be valid, a proxy form, and the original or duly certified copy of the power of attorney or other authority (if any) under which it is signed or authenticated, should reach the Company's registrars, Computershare Investor Services Plc of PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH, by no later than 10.00 a.m. on 10 May 2011.
(v) The notes to the proxy form include instructions on how to appoint a proxy by using the CREST proxy appointment service. You may not use any electronic address provided either in this notice of AGM or in any related documents (including the proxy form) to communicate with the Company for any purposes other than those expressly stated.
(vi) In the case of joint holders of shares, the vote of the first named in the register of members who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of other joint holders.
(vii) The following information is available at www.zotefoams.com: (1) the matters set out in this notice of AGM; (2) the total numbers of shares in the Company, and shares in each class, in respect of which members are entitled to exercise voting rights at the AGM, (3) the totals of the voting rights that members are entitled to exercise at the AGM, in respect of the shares of each class; and (4) members' statements, members' resolutions and members' matters of business received by the Company after the first date on which notice of the AGM was given.
(viii) If you are a person who has been nominated by a member to enjoy information rights in accordance with section 146 of the Companies Act 2006, Notes (iii) to (v) above does not apply to you (as the rights described in these Notes can only be exercised by members of the Company) but you may have a right under an agreement between you and the member by whom you were nominated to be appointed or to have someone else appointed, as a proxy for the meeting. If you have no such right or do not wish to exercise it, you may have a right under such an agreement to give instructions to the member as to the exercise of voting rights.
(ix) A member that is a company or other organisation not having a physical presence cannot attend in person but can appoint someone to represent it. This can be done in one of two ways: Either by the appointment of a proxy (described in Notes (iii) to (v) above) or of a corporate representative. Members considering the appointment of a corporate representative should check their own legal position, the Company's articles of association and the relevant provision of the Companies Act 2006.
(x) Members attending the AGM have the right to ask, and, subject to the provisions of the Companies Act 2006, the Company must cause to be answered, any questions relating to the business being dealt with at the AGM.
(xi) As at 10.00 a.m. on 31 March 2011, the Company's issued share capital comprised 38,297,093 ordinary shares of 5 pence each. Each ordinary share carries the right to one vote at a general meeting of the Company. No ordinary shares were held in treasury and accordingly the total number of voting rights in the Company as at 10.00 am on 31 March 2011 is 38,297,093.
(xii) Shareholders should note that it is possible that, pursuant to requests made by shareholders of the Company under section 527 of the Companies Act 2006, the Company may be required to publish on a website a statement setting out any matter relating to: (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the AGM; or (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Companies Act 2006. The Company may not require the shareholders requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Companies Act 2006. Where the Company is required to place a statement on a website under section 527 of the Companies Act 2006, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the AGM includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.
(xiii) In accordance with section 338 of the Companies Act 2006, a member or members of the Company may (provided that the criteria set out in section 338(3) of the Companies Act 2006 are met) require the Company to give to members notice of a resolution which may properly be moved and is intended to be moved at the AGM, provided that: (a) the resolution must not be, if passed, ineffective (whether by reason of inconsistency with any enactment or the Company's constitution or otherwise); and (b) the resolution must not be defamatory of any person, frivolous or vexatious. Such a request may be in hard copy form or in electronic form, must be authenticated by the person or persons making it, must identify the resolution of which notice is to be given and must be received by the Company not later than 6 weeks before the AGM, or, if later, the time at which notice is given of the AGM. (In the foregoing sentence, the terms 'hard copy form', 'electronic form' and 'authenticated' bear their respective meanings set out in the Companies Act 2006 in relation to a communication, or a document or information sent or supplied, to a company.)
(xiv) In accordance with section 338A of the Companies Act 2006, a member or members of the Company may (provided that the criteria set out in section 338A(3) of the Companies Act 2006 are met) require the Company to include in the business to be dealt with at the AGM a matter (other than a proposed resolution) which may properly be included in the business of the AGM, provided that the matter is not defamatory of any person, frivolous or vexatious. A request may be in hard copy form or electronic form, must identify the matter to be included in the business, must be accompanied by a statement setting out the grounds for the request, must be authenticated by the person or persons making it and must be received by the Company not later than six weeks before the AGM, or, if later, the time at which notice is given of the AGM. (In the foregoing sentence, the terms 'hard copy form', 'electronic form' and 'authenticated' bear the respective meanings set out in the Companies Act 2006 in relation to a communication, or a document or information sent or supplied, to a company.)
(xv) Copies of the Executive Directors' service contracts with the Company and any of its subsidiary undertakings and letters of appointment of the non-executive Directors are available for inspection at the registered office of the Company during the usual business hours on any weekday (Saturday, Sunday or public holidays excluded) from the date of this notice until the conclusion of the AGM.

**Explanatory notes to the resolutions**
**Ordinary Business**
**Resolution 1 – Receiving the accounts and reports**
All quoted companies are required by law to lay their annual accounts and reports before a general meeting of the Company, together with the Directors' Report, Directors' Remuneration Report, and auditor's report on the accounts, the Directors' Report and the section of the Directors' Remuneration Report subject to audit. At the AGM, the Directors will present these documents to the shareholders for the financial year ended 31 December 2010.

**Resolution 2 – Remuneration Report**
All quoted companies are required by law to produce for each financial year a Directors' Remuneration Report which sets out the Remuneration Committee's policy in relation to Directors' remuneration, together with the remuneration and benefits paid to Directors during the year. The Company is also required to put an ordinary resolution to shareholders approving the report at the meeting at which the Company's report and accounts for that year are laid. Accordingly, resolution 2 seeks the approval of the Directors' Remuneration Report which is set out on pages 24 to 28 of the report and accounts for the financial year ended 31 December 2010.

The vote is advisory in nature and will have no effect on the remuneration of individual Directors for the year under review. It will, however, provide shareholders with the means to express their opinion concerning remuneration matters and promote dialogue in respect of policy.

**Resolution 3 – Declaration of dividend**
This resolution concerns the Company's final dividend payment. The Directors are recommending a final dividend of 3.15 pence per ordinary share in respect of the year ended 31 December 2010 which, if approved, will be payable on 24 May 2011 to the shareholders on the register of members on 26 April 2011.

**Resolutions 4 and 5 – Re-election of Directors**
These resolutions concern the re-election of R J Clowes and R H Lawson who are retiring at the meeting by rotation in accordance with article 89 of the Company's articles of association.

R J Clowes and R H Lawson are non-executive Directors. Biographies for these Directors are set out on page 20 of the report and accounts for the year ended 31 December 2010.

**Special Business**

**Resolution 7 – Directors' power to allot shares**

This resolution grants the Directors authority to allot shares in the capital of the Company and other relevant securities up to an aggregate nominal value of £638,221, representing approximately one-third (33.33%) of the nominal value of the issued ordinary share capital of the Company as at 31 March 2011, being the latest practicable date before publication of this notice. In addition, in accordance with the latest institutional guidelines issued by the Association of British Insurers ('ABI'), paragraph (b) of resolution 7 grants the Directors authority to allot further equity securities up to an aggregate nominal value of £1,276,663, representing approximately two-thirds (66.67%) of the nominal value of the issued ordinary share capital of the Company as at 31 March 2011, being the latest practicable date before publication of this notice. This additional authority may be only applied to fully pre-emptive rights issues.

The intention of the authority granted pursuant to paragraph (b) of resolution 7 is to preserve maximum flexibility and to keep the Company in line with what is expected to become standard practice for listed companies and if the Directors do exercise this authority, they intend to follow emerging best practice as regards its use (including the Directors standing for re-election in certain cases), as recommended by the ABI.

The Company does not currently hold any shares as treasury shares within the meaning of section 724 of the Companies Act 2006 ('Treasury Shares').

Save in respect of the issue of new ordinary shares pursuant to the share incentive schemes, the Directors do not have any present intention of exercising the authorities conferred by resolution 7 but they consider it desirable that the specified amount of authorised but unissued share capital is available for issue so that they can more readily take advantage of possible opportunities.

Unless revoked, varied or extended, this authority will expire at the conclusion of the next AGM of the Company or the date falling 18 months from the passing of the resolution, whichever is the earlier.

**Resolution 8 – Authority to allot shares disregarding pre-emption rights**

This resolution authorises the Directors in certain circumstances to allot equity securities for cash other than in accordance with the statutory pre-emption rights (which require a company to offer all allotments for cash first to existing shareholders in proportion to their holdings). The relevant circumstances are either where the allotment takes place in connection with a rights issue or the allotment is limited to a maximum nominal amount of £95,742, representing approximately 5% of the nominal value of the issued ordinary share capital of the Company as at 31 March 2011 being the latest practicable date before publication of this notice. Unless revoked, varied or extended, this authority will expire at the conclusion of the next AGM of the Company or 18 months after the passing of the resolution, whichever is the earlier.

**Treasury shares regulations**

The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (as amended) ('Treasury Shares Regulations') give flexibility concerning what the Company can do with any of its ordinary shares that it may buy back. The Company may now hold such shares 'in treasury' and then sell them at a later date for cash rather than simply cancelling them. The Treasury Shares Regulations require such sales to be on a pre-emptive, pro-rata basis to existing shareholders unless shareholders agree by special resolution to disapply such pre-emption rights. Accordingly, in addition to giving the Directors power to allot unissued ordinary shares on a non pre-emptive basis, resolution 8 will also give Directors power to sell ordinary shares held in treasury on a non- pre-emptive basis, subject always to the limitations noted above.

The Directors consider that the power proposed to be granted by resolution 8 is necessary to retain flexibility, although they do not have any intention at the present time of exercising such power.

**Resolution 9 – Authority to purchase shares (market purchases)**

This resolution authorises the Board to make market purchases of up to 3,829,709 ordinary shares (representing approximately 10% of the Company's issued ordinary shares as at 31 March 2011, being the latest practicable date before publication of this notice). Shares so purchased may be cancelled or held as treasury shares. The authority will expire at the end of the next Annual General Meeting of the Company or 18 months from the passing of the resolution, whichever is the earlier. The Directors intend to seek renewal of this authority at subsequent Annual General Meetings.

The minimum price that can be paid for an ordinary share is 5 pence being the nominal value of an ordinary share. The maximum price that can be paid is 5% over the average of the middle market prices for an ordinary share, derived from the Daily Official List of the London Stock Exchange, for the five business days immediately before the day on which the share is contracted to be purchased.

The Directors intend to exercise this right only when, in light of the market conditions prevailing at the time and taking into account all relevant factors (for example, the effect on earnings per share), they believe that such purchases are in the best interests of the Company and shareholders generally. The overall position of the Company will be taken into account before deciding upon this course of action. The decision as to whether any such shares bought back will be cancelled or held in treasury will be made by the Directors on the same basis at the time of the purchase.

As at 31 March 2011, being the latest practicable date before publication of this notice, there were outstanding awards under the Company's long term incentive schemes in respect of 1,482,396 ordinary shares in the capital of the Company representing 3.9% of the Company's issued ordinary share capital. If the authority to purchase the Company's ordinary shares were exercised in full, such options would represent 4.3% of the Company's issued ordinary share capital.

**Resolution 10 – Notice period for general meetings**

This resolution is required to reflect the implementation on 3 August 2009 of the EU Shareholder Rights Directive. The regulations implementing this Directive have increased the default notice period for general meetings of the Company to 21 clear days. The Company would like to have the ability (as it did before 3 August 2009) to call general meetings (other than an AGM) on 14 clear days' notice. In order to be able to do so after 3 August 2009, shareholders must have approved the calling of meetings on 14 days' notice. Resolution 10 seeks such approval and a similar resolution was passed at the Company's last Annual General Meeting. The approval will be effective until the Company's next Annual General Meeting, when it is intended that a similar resolution will be proposed. The Company will also need to meet the requirements for electronic voting under the Directive before it can call a general meeting on 14 days' notice. The Company intends to follow emerging institutional guidance as regards calling general meetings on 14 days' notice whereby, such notice would only be given when the proposals are time-sensitive and the short notice would clearly be in shareholders' interests.

# Five Year Trading Summary

| | **2010 £m** | 2009 £m | 2008 £m | 2007 £m | 2006 £m |
|---|---|---|---|---|---|
| Turnover | **39.9** | 31.8 | 34.8 | 31.6 | 30.1 |
| Operating profit (excluding exceptional items) | **4.8** | 3.4 | 4.0 | 3.5 | 2.8 |
| Profit before tax (excluding exceptional items) | **4.7** | 3.2 | 3.9 | 3.4 | 2.7 |
| Profit before tax (including exceptional items) | **5.8** | 2.7 | 3.9 | 3.4 | 1.6 |
| Profit after tax (including exceptional items) | **4.8** | 2.2 | 3.0 | 2.9 | 1.2 |
| Capital expenditure | **2.7** | 3.4 | 1.4 | 2.7 | 2.6 |
| Cash generated from the operations | **7.2** | 7.0 | 5.8 | 4.8 | 4.7 |
| Basic earnings per share excluding exceptional items (p) | **10.2** | 6.8 | 8.3 | 8.0 | 5.4 |
| Basic earnings per share including exceptional items (p) | **13.1** | 5.9 | 8.3 | 8.0 | 3.4 |
| Dividends per ordinary share (p) | **4.65** | 4.50 | 4.50 | 4.50 | 4.50 |

# Financial Calendar

| | |
|---|---|
| AGM | 12 May 2011 |
| Payment of final dividend | 24 May 2011 to shareholders on the register at the close of business on 26 April 2011 |
| Announcement of 2011 interim results | August 2011 |
| Payment of interim dividend | October 2011 |
| Announcement of 2011 results | March 2012 |

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

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

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