

26th May 2005

APPLIED OPTICAL TECHNOLOGIES plc
(“Applied Optical Technologies” or “the Group”)

Preliminary Announcement of Results For The Year Ended 31st March 2005

Applied Optical Technologies plc, the supplier of anti-counterfeiting technologies and services announces its results for the year ended 31st March 2005.

Highlights

	2005	2004 As restated
Group turnover	£23.7m	£26.1m
Adjusted operating loss*	£(0.5m)	£(0.3m)
Adjusted loss per share*	(2.6)p	(2.2)p

*before goodwill amortisation, exceptional items and impairments
(see notes 2 c) and 8)

- The American operations reported record results for the year, with strong performance across all business segments.
- The 3dcd joint venture again contributed strong earnings of £0.7 million (2004: £1.0 million).
- Continued problems in Europe led to the decision to restructure radically the operations by exiting loss making markets. The restructuring was largely completed by the end of the year with the ongoing operations continuing to serve the Group’s key security markets.
- As at 31st March 2005 the Group had net cash balances of £4.0 million and net funds of £3.9 million.

David Mahony, Chairman, said:

“The continuing success of our American operations, coupled with an encouraging start to the year from our now restructured European operations leads us to anticipate a marked improvement in the Group’s fortunes in the current year. The Board expect the interim results for the six months ending 30th September 2005 to reflect this improvement.

- Ends -

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26th May 2005

APPLIED OPTICAL TECHNOLOGIES plc
(“Applied Optical Technologies” or “the Group”)

Preliminary Announcement of Results For The Year Ended 31st March 2005

CHAIRMAN'S STATEMENT

Introduction

Our American operations performed successfully in the year to 31st March 2005. The Parkton, Maryland operation obtained further extensions to the NFL and NHL brand protection programmes and won other significant business. The Lancaster, Pennsylvania plant, which focuses primarily on the ID Technologies market, secured a number of new contracts, both in America and overseas. This, coupled with a programme of improvements to manufacturing efficiency, resulted in a much improved performance for Lancaster.

Inevitably, given the continued strength of sterling against the US dollar, some of the growth in America was masked by currency movements.

3dcd, despite the expected absence of major new product launches in the period by its prime customer, achieved a good result for the year. This was aided by the success of the programme to incorporate 3dcd's technology on a major studio's DVDs in Europe.

The Group has suffered from the inability of its European operations to achieve turnover levels sufficient to match its cost base. As previously reported, various routes to closing this gap have been investigated over the past two years. Given the continuing levels of losses, the decision was taken last year to restructure radically the European operations. Production was unified onto one site, the product range was narrowed and staff levels were reduced by half.

The European operations have retained the capability to supply a wide range of products to the Group's three core security markets. Throughout the process, deliveries to continuing customers in these markets were maintained.

This exercise has inevitably resulted in substantial exceptional costs but it should be noted that in the second half of the year to 31st March 2005, the Group achieved an adjusted operating profit of £147,000 and that the Group's cash position remains strong with minimal borrowings and cash at the year end of £4.0 million.

Management

In the year to 31st March 2005, a number of changes affecting the Board took place. Peter Emerson left the company as part of the European restructuring, Mike Angus relocated to America and Rick Salomone, whilst continuing as President of American Operations, resigned from the Board of the public company.

Shareholder Relations

It has become increasingly clear to the Board that the reporting and regulatory requirements required of fully listed companies are both expensive and difficult to justify for a smaller company. Having consulted all of the Group's advisors and major shareholders, the decision has been taken to apply to join the Alternative Investment Market by 30th September 2005. The Board recognises that this will have disadvantages for some shareholders but the benefits to the Company as a whole require that this change is made.

Staff

The Board wishes to record its thanks to all staff who were parties both to achieving the results in America and working through a period of exceptional disruption in the European operations.

Outlook

The Board is conscious that expectations of improved performance in recent years have not been met but the continuing success of our American operations, coupled with an encouraging start to the year from our now restructured European operations, lead us to expect a marked improvement in the Group's performance in the current year. The Board expects the interim results for the six months ending 30th September 2005 to reflect this improvement.

DA Mahony
Chairman
26th May 2005

OPERATING AND FINANCIAL REVIEW

Review of Operations

During the year the Group's American operations reported record results, with strong performances across all market segments. A number of major contracts were signed and renewed and orders received. The Group's 3dcd joint venture also delivered results in excess of expectations, in part due to its success in extending its activities to DVD protection. The Group's European operations continued to be loss making and a decision was taken to undertake a comprehensive restructuring; this included exiting loss making markets, consolidating manufacturing facilities and reducing the workforce in the UK.

The year to 31st March 2005 saw Group turnover fall by 9% to £23.7 million (2004: £26.1 million) and an adjusted operating loss of £0.5 million compared to £0.3 million in the previous year. After adjusting for exceptional costs of £4.1 million (2004: £nil), goodwill amortisation of £1.1 million (2004: £1.2 million) and goodwill impairment of £0.4 million (2004: £nil) the Group made an operating loss of £6.1 million (2004: £1.5 million). The loss before taxation amounted to £6.1 million (2004: £1.5 million).

Review of Sales Activities

At the outset of the year, the Group competed in discrete market segments under four brands—AOT Banknote and High Security Documents, OpSec Brand Protection, Advantage ID Technologies, and Applied Product Enhancement. The restructuring of the European operations during the year led to an exit from the Applied Product Enhancement business, and as from 1st April 2005 the Group has conducted its business in the three security sectors under the OpSec name.

– OpSec Banknote and High Security Documents

Results in this market segment fell by 22% from £8.3 million to £6.5 million. This was largely due to the expected cyclical down turn in the temporary licence plate business with AAMVA coupled with the failure to secure any euro banknote foil business.

As part of the restructuring of its European operations, the Group has exited the market for euro banknote foils but continues to supply a number of other customers for banknote applications. Volumes and demand in this area continue to be robust.

The Group also continues to serve the market for tax stamps and secured two new customers during the year, while continuing successfully to supply its existing business in this sector. This success was particularly notable given that this business was delivered from the Group's UK manufacturing facilities in the midst of the reorganisation and restructuring. It is expected that the market for these types of products will continue to grow and that the Group will be able to continue to compete effectively for this type of business.

The Group also secured in the latter part of the financial year significant new business for a government security application in America. The benefits of this contract will be seen in the current financial year.

– **OpSec Brand Protection**

Turnover in the brand protection market fell by 2% to £9.4 million due primarily to a 9% decline in the average dollar exchange rate.

During the year the Group was awarded multi-year contract extensions to its brand protection programmes with the National Football League and The National Hockey League. Following the multi-year contract renewals in the prior year for Major League Baseball and the National Basketball Association, the Group continues to serve all four major US sports leagues.

New contracts were signed with two international brand owners for brand and product protection products, and the Group's new labels for DVD anti-counterfeiting protection achieved significant success in Europe.

The Group continues to offer a broad array of products and services to this market, and believes it is well positioned both to maintain current profitability and successfully to expand its business in this market.

– **OpSec ID Technologies**

The Group saw a 17% increase in turnover in its ID business from £5.6 million to £6.6 million.

The Group's American ID business, which had suffered a downturn in the prior year, returned to prior levels of profitability due to increased business from existing customers and a number of new accounts. New business was secured for use in Iraq, Afghanistan and Pakistan, demonstrating the strength and awareness in the market of the Group's ID authentication technologies in areas demanding the highest level of security. Improvements in the efficiency of the manufacturing facility in Lancaster, Pennsylvania also contributed to the sales growth.

The Group continues to invest heavily in the ID sector to accommodate increasing demand by governments for secure ID products.

American Operations

On a dollar basis, turnover in our American Operations increased by 10% and operating profits before corporate recharges increased by 39%. Strong growth in brand protection and, especially, ID Systems offset the cyclical down turn in the temporary license plate business with AAMVA.

The continuation of the Group's strong presence in brand protection was seen in the renewal of key contracts; new contracts were secured in the government security area, and the ID business saw a substantial turnaround from the prior year.

Both American manufacturing facilities showed progress in increasing efficiency and productivity of output, with gross margins improving in both locations. Several new products for authentication technologies were successfully launched during the year and the Group's market position in America continues to be strong and stable.

European Operations

The European operations saw a decrease in turnover of 17% and an increase in operating losses before corporate recharges of 7%. These losses led to the decision during the year to restructure comprehensively the operations. Key elements of this restructuring included a reduction in staff from 164 to 83; an exit from the supply of euro foils, brand enhancement and metallising businesses; and

a consolidation of its UK based manufacturing facilities. Peter Emerson, the Managing Director, left the Board of Directors and the European management team has been restructured. In addition, the Group surrendered the lease of its main manufacturing site at Crowther and simultaneously entered into a new lease for the same premises on a reduced rent and with a shorter break period. The lease surrendered carried a high rent consistent with the facilities provided by the landlord to enable the supply of Euro banknote foils. The exit costs of £1.1 million have been charged as an exceptional item. The new lease now reflects the commercial rates appropriate to the markets served by the remaining business.

During the financial year the Group also completed the sale of its property at Grove Park, Leicester and leased back parts of the building. We expect this operation to be relocated to a nearby site within the current financial year.

The restructuring of the UK operations has largely been completed, and the operations are now focused on key security markets where the Group has a successful track record. The exceptional costs associated with the restructuring have been reflected in these accounts and further costs are not expected to impact the current year. The early signs are encouraging and we are confident that results for the current year will show significant progress.

Research and Development

The Group continues to invest heavily in research and development and a significant percentage of the Group's expenditure is focused on new ID products. New generation optical elements and other types of technologies, including radio frequency based authentication technologies, are being developed either internally or with external partners to accommodate increasing demand by customers for authentication products.

In addition the Group continues to invest in the development of its optical technologies, which constitute a key element of its technical capabilities.

Joint Venture

The contribution from the Group's 50% share in 3dcd decreased from £1.0 million to £0.7 million, reflecting the anticipated lower sales of product by its software customer. The impact of this was partially offset by strong sales of its inner mirror band for DVD authentication within Europe. The joint venture recently agreed to extend this product into Latin America with a major studio customer.

Taxation

The corporation tax charge in the year ended 31st March 2005 relates to overseas taxation in respect of income which cannot be fully relieved by brought forward trading losses. The remainder of the charge relates to deferred taxation.

Earnings Per Share

The basic and fully diluted loss per share for the year was 13.7 pence (2004: 4.5 pence as restated).

On an adjusted basis (removing the effect of goodwill amortisation and impairment and exceptional items) the loss per share was 2.6 pence (2004: 2.2 pence as restated) on a non-diluted basis and on a fully diluted basis.

Cash Flow and Financing

The Group had a net cash outflow from operating activities for the year of £0.5 million (2004: £0.3 million).

As at 31st March 2005, the Group had net cash at bank and in hand of £4.0 million (2004: £1.1 million) and net funds of £3.9 million (2004: £1.1 million).

Treasury

Whilst a substantial proportion of the Group's revenue and profit is earned outside the UK, subsidiaries generally trade in their own currency. The Group is therefore not subject to any significant foreign exchange transaction exposure. The Group's principal exposure to foreign currency lies in the translation of overseas profits into sterling.

Capital Expenditure

Capital expenditure in the year was £1.1 million (2004: £1.0 million).

The major expenditure in the year related to upgrading the manufacturing capabilities of our Lancaster operations.

The Group's main capital commitments relate to completion of the unification of the UK manufacturing sites and to the Group's optical imaging and colour-shifting technologies.

Shareholders' Funds

Shareholders' funds decreased during the year from £25.6 million to £16.7 million. These represent a net asset value of 31 pence per share (2004: 48 pence per share).

Urgent Issues Task Force Abstract 38 *Accounting for ESOP Trusts* has been adopted for the first time resulting in a restatement of the 2004 Accounts. Further details are given in Note 1.

International Financial Reporting Standards

The Company's decision to move to the Alternative Investment Market means that International Financial Reporting Standards (IFRS) will not impact its accounting policies until the year ending 31st March 2008. Consequently, a detailed assessment of the potential impact of IFRS has not yet been undertaken.

M Turnage
Chief Executive
26th May 2005

Applied Optical Technologies plc
Consolidated Profit and Loss Account
For the year ended 31st March 2005

	2005	2004
	£'000	(as restated) £'000
Turnover; Group and share of joint venture	25,203	28,271
Less; share of joint venture's turnover	(1,456)	(2,214)
Group turnover	23,747	26,057
Cost of sales	(16,202)	(18,042)
Gross profit	7,545	8,015
Goodwill impairment	(417)	-
Exceptional items	(4,069)	-
Goodwill amortisation	(1,093)	(1,203)
Other operating expenses	(8,825)	(9,318)
Net operating expenses	(14,404)	(10,521)
Group operating loss	(6,859)	(2,506)
Share of operating profit of joint venture	735	993
Operating loss	(6,124)	(1,513)
Interest receivable and similar income	36	(26)
Income from other investments	7	-
Interest payable and similar charges	(7)	46
Loss before taxation	(6,088)	(1,493)
Taxation	(808)	(796)
Retained loss for the financial year	(6,896)	(2,289)
Basic loss per share	(13.7)p	(4.5)p
Diluted loss per share	(13.7)p	(4.5)p
Adjusted basic loss per share	(2.6)p	(2.2)p
Adjusted diluted loss per share	(2.6)p	(2.2)p

All results above relate to continuing operations

Applied Optical Technologies plc
Consolidated Balance Sheet
As at 31st March 2005

	2005	2004
	£'000	(as restated) £'000
Fixed assets		
Intangible assets	4,928	6,582
Tangible assets	5,084	10,654
Investments		
Investments in joint venture		
Share of gross assets	764	913
Share of gross liabilities	(313)	(237)
	<u>451</u>	<u>676</u>
Other investments	<u>28</u>	<u>28</u>
	<u>10,491</u>	<u>17,940</u>
Current assets		
Stocks	2,101	2,522
Debtors		
- amounts falling due within one year	4,787	6,918
- amounts falling due after more than one year	889	1,545
	<u>5,676</u>	<u>8,463</u>
Cash at bank and in hand	3,954	1,851
	<u>11,731</u>	<u>12,836</u>
Creditors: Amounts falling due within one year	<u>(5,549)</u>	<u>(6,750)</u>
Net current assets	<u>6,182</u>	<u>6,086</u>
Total assets less current liabilities	16,673	24,026
Creditors: Amounts falling due after more than one year	(22)	(56)
Net assets	<u>16,651</u>	<u>23,970</u>
Capital and reserves		
Called up equity share capital	2,669	2,669
Share premium account	53,160	53,160
Profit and loss account	(39,178)	(31,859)
Equity shareholders' funds	<u>16,651</u>	<u>23,970</u>

Applied Optical Technologies plc
Consolidated Cash Flow Statement
For the year ended 31st March 2005

	2005	2005	2004	2004
	£'000	£'000	£'000	£'000
Cash outflow from operating activities		(522)		(342)
Dividends received from joint venture		932		602
Returns on investments and servicing of finance		37		(40)
Taxation		(80)		(97)
Capital expenditure and financial investment		2,544		(1,001)
Cash inflow/(outflow) before financing		2,911		(878)
Financing				
Issue of shares	-		29	
Decrease in debt	(33)		(433)	
Net cash outflow from financing		(33)		(404)
Increase/(decrease) in cash in the year		2,878		(1,282)
<hr/>				
Reconciliation of net cash flow to movement in net funds				
Increase/(decrease) in cash in the year		2,878		(1,282)
Cash outflow from decrease in debt and lease financing		33		433
Change in net funds resulting from cash flows		2,911		(849)
Foreign exchange movements		(73)		(316)
Movement in net funds in year		2,838		(1,165)
Net funds at 1st April 2004		1,102		2,267
Net funds at 31st March 2005		3,940		1,102

Applied Optical Technologies plc
Statement of Group Total Recognised Gains and Losses
For the year ended 31st March 2005

	2005	2004 (as restated)
	£'000	£'000
Loss for the financial year attributable to shareholders	(6,896)	(2,289)
Translation of net foreign currency investments	(423)	(2,837)
Total gains and losses relating to the year	(7,319)	(5,126)

Reconciliation of Group Movements in Shareholders' Funds
For the year ended 31st March 2005

	2005	2004 (as restated)
	£'000	£'000
Loss for the financial year attributable to shareholders	(6,896)	(2,289)
Translation of net foreign currency investments	(423)	(2,837)
Sale of shares from Employee Benefit Trust	-	29
Movement for the year	(7,319)	(5,097)
Opening shareholders' funds - as previously stated	25,578	30,741
Prior year adjustment	(1,608)	(1,674)
Opening shareholders' funds – as restated	23,970	29,067
Closing shareholders' funds	16,651	23,970

Applied Optical Technologies plc
Notes to the Preliminary Announcement
For the year ended 31st March 2005

- 1) The financial information contained in this announcement does not constitute the Company's statutory accounts for the years ended 31st March 2004 or 2005 but is derived from those accounts. Statutory accounts for 2004 have been delivered to the registrar of companies, and those for 2005 will be delivered following the Company's Annual General Meeting. The auditors have reported on those accounts; their reports were unqualified and did not contain statements under section 237 (2) or (3) of the Companies Act 1985.

Urgent Issues Task Force Abstract 38 *Accounting for ESOP Trusts* has been adopted for the first time resulting in a restatement of the 2004 accounts. The Abstract requires that the Company's own shares held by the Employee Benefit Trusts are deducted from shareholders' funds until they vest unconditionally with employees. Prior to the adoption of UITF 38 these shares were recognised as fixed asset investments. As a result, investments and shareholders funds as at 31st March 2004 have each been reduced by £1,608,000.

2) Segment Information

	2005	2004
	£'000	£'000
a) Turnover by market sector		
Banknote and high security documents	6,519	8,337
Brand protection	9,386	9,600
Brand protection via joint venture	1,456	2,214
ID technologies	6,562	5,631
Product enhancement	756	1,388
Metallising	310	528
Other	214	573
	<u>25,203</u>	<u>28,271</u>
b) Turnover by geographical origin		
American operations	14,398	14,281
American operations via joint venture	1,456	2,214
European operations	11,168	13,397
Inter-segment sales	(1,819)	(1,621)
	<u>25,203</u>	<u>28,271</u>
c) Operating loss by geographical origin		
American operations	979	1,011
European operations	(7,103)	(2,524)
Operating loss	(6,124)	(1,513)
Exclude goodwill amortisation	1,093	1,203
Exclude goodwill impairment	417	-
Exclude exceptional items	4,069	-
Adjusted operating loss	<u>(545)</u>	<u>(310)</u>
Adjusted operating (loss)/profit arises from		
American operations	1,350	1,171
European operations	(2,630)	(2,474)
Joint Venture	735	993
	<u>(545)</u>	<u>(310)</u>

Applied Optical Technologies plc
Notes to the Preliminary Announcement
For the year ended 31st March 2005

3) Net Operating Expenses

	2005	2004
	£'000	£'000
Distribution Costs		
Selling and Marketing costs	<u>3,267</u>	<u>3,591</u>
Administrative Expenses		
Technical Support	450	557
Research and development costs	1,036	1,075
Administrative costs	4,072	4,095
Exceptional costs	4,069	-
Goodwill amortisation	1,093	1,203
Goodwill impairment	417	-
	<u>11,137</u>	<u>6,930</u>
Net Operating Expenses	<u>14,404</u>	<u>10,521</u>

Exceptional items included within administrative expenses

Lease surrender costs	1,093	
Reorganisation costs	1,765	-
Profit on disposal of tangible fixed assets	(4)	-
Tangible fixed asset impairment	1,215	-
	<u>4,069</u>	<u>-</u>

4) Share of Operating Profit of Joint Venture

The share of operating profit of joint venture represents the Group's share of the results of 3dcd for the year ended 31st March 2005.

5) Interest Receivable and Similar Income

	2005	2004
	£'000	£'000
Bank interest receivable	41	11
Exchange losses on foreign currency deposits	(5)	(37)
	<u>36</u>	<u>(26)</u>

Applied Optical Technologies plc
Notes to the Preliminary Announcement
For the year ended 31st March 2005

6) Interest Payable and Similar Charges

	2005	2004
	£'000	£'000
On bank loans and overdrafts	22	46
On finance leases and hire purchase agreements	3	5
Exchange gains on foreign currency borrowings	(18)	(97)
	<u>7</u>	<u>(46)</u>

7) Taxation

	2005	2004
	£'000	£'000
<u>Overseas Tax</u>		
Corporation Tax	69	386
Deferred Tax	739	410
	<u>808</u>	<u>796</u>

No taxation is payable in the current year by any of the Group's UK based companies due to trading losses incurred.

Corporation tax on profits arising in the Group's American subsidiaries is limited to state taxes and statutory minima due to losses brought forward from prior years. Corporation tax arising on the Group's joint venture has been reduced by losses brought forward.

At 31st March 2005 the Group had a deferred tax asset of £1,586,000 (2004: £2,373,000) due to losses available in America to carry forward to offset against future profits of the same trades and other short term timing differences.

At 31st March 2005 the Group had additional tax losses in respect of European operations. No deferred tax asset has been recognised in respect of these losses.

Applied Optical Technologies plc
Notes to the Preliminary Announcement
For the year ended 31st March 2005

8) Loss Per Share

The calculations of earnings per share are based upon the following losses and numbers of shares.

	2005	2004 (as restated)
	£'000	£'000
Earnings		
Loss for the financial year (basic and diluted EPS)	<u>(6,896)</u>	<u>(2,289)</u>
Adjusted earnings		
Loss for the financial year	(6,896)	(2,289)
Exclude goodwill amortisation	1,093	1,203
Exclude goodwill impairment	417	-
Exclude exceptional items in Operating Expenses	4,069	-
Adjusted loss (basic and diluted)	<u>(1,317)</u>	<u>(1,086)</u>
Weighted average number of shares	No. of shares	No. of shares
For basic and diluted EPS	<u>50,516,234</u>	<u>50,482,935</u>

Applied Optical Technologies plc
Notes to the Preliminary Announcement
For the year ended 31st March 2005

9) Notes to the Cash Flow Statement

Reconciliation of Group Operating Loss to Operating Cash Flows

	2005	2004
	£'000	£'000
Group operating loss	(6,859)	(2,506)
Depreciation	1,946	2,214
(Profit)/Loss on sale of fixed assets	(4)	21
Goodwill amortisation	1,093	1,203
Goodwill impairment	417	-
Fixed asset impairment	1,215	-
Movement in stocks	383	(177)
Movement in debtors	1,932	(1,733)
Movement in creditors	(645)	636
Net cash outflow from operating activities	<u>(522)</u>	<u>(342)</u>

Analysis of Net Funds

	At 1 st April 2004 £'000	Cashflows £'000	Exchange adjustments £'000	At 31 st March 2005 £'000
Cash at bank and in hand	1,851	2,176	(73)	3,954
Bank overdraft	(702)	702	-	-
Hire purchase agreement and finance leases	(47)	33	-	(14)
	<u>1,102</u>	<u>2,911</u>	<u>(73)</u>	<u>3,940</u>

- 10)** A copy of the preliminary statement is available from the Company Secretary, 40 Phoenix Road, Crowther District 3, Washington, Tyne & Wear, NE38 0AD.
- 11)** The preliminary announcement was approved by the Board of Directors for release on 26th May 2005.

- Ends -