



Datong Electronics

Datong Electronics PLC
Interim Report and Accounts for the six months ended 30 September 2006



WHO WE ARE

DATONG ARE A GLOBAL PROVIDER OF ADVANCED INTELLIGENCE GATHERING EQUIPMENT TO THE WORLD'S GOVERNMENT DEFENCE AND LAW ENFORCEMENT AGENCIES.

We strive to maintain an excellent reputation that exceeds customer expectations for robust and reliable products, technical support and customer service.

We are a Company that has high levels of growth and maintains sustainable profitability.

Using the latest technology we work with our customers to develop and produce solutions that fulfil their needs.

We develop the skills of our employees to be professional in all that they do and to enhance both their job satisfaction and the quality of our products and services.

IFC WHO WE ARE

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HIGHLIGHTS

Results in line with expectations

Turnover up 39% to £3.4m (2005: £2.4m)

Profit before tax and exceptional items increase to £120,000
(2005: loss of £30,000)

Strong balance sheet incorporating net funds of £1.2m

Market remains buoyant

Board strengthened

CHAIRMAN'S STATEMENT



The Board is pleased to present its interim report for the six months ended 30 September 2006.

MARKETS AND BUSINESS DEVELOPMENTS

The market for Datong's products remains buoyant and we continue to be positive about our future. Recent market research has estimated that continued growth in homeland security and defence spending will be seen around the globe, ranging from 12% to 25% per annum until 2015 (source: Management and HLS/HLD Global Market Outlook 2006–2015). We enjoy a leading position in our markets and expect to benefit as our customers increasingly recognise the important role intelligence gathering technology can play in the fight against terrorism and organised crime.

In the period we maintained our strong momentum in organic sales growth, recovering from the order delays experienced in the fourth quarter of the last financial year, and achieving a 39% increase in revenue to £3.3m. Furthermore, having absorbed the additional overhead costs of being a public limited company and the continuing adverse impact of a weak US dollar, operating profit before exceptional items increased to £87,000 (2005: loss of £47,000).

The US has been a particularly strong market in the period, in part benefiting from order delays from the last financial year but also reflecting the benefits from recent investments in product development and improvements in our distribution channels in that territory. We do not expect to see any adverse impact on our customers spending following the recent ascension to power in Congress by the Democrats. Their stated plan is to rebuild a state of the art military capable of projecting power wherever necessary and to double the size of the military's special operations, indicating a potential increase in spend on high technology products.

In the UK, although revenue for the period is down on last year's particularly strong performance, the level of business is still promising and ahead of recent years with a high level of interest in our new products.

In part supported by the new money raised on our admission to AIM in October 2005, we have continued to make strong progress in a consistent strategy targeting product development and organic growth. Two new RF beacons have been successfully launched in the period, both smaller than their predecessors and with added functionality, and have been well received with significant orders particularly from the US market. The new products introduced during the latter part of the last financial year have also continued to sell well in the period. We have an innovative development pipeline in place with further demands from the US market for specific new products to fulfil user requirements.

Significant improvements have been made to our production capability both in terms of increasing capacity and further improving product quality.

We have a strong balance sheet and are actively looking for complementary acquisitions of businesses and/or technology to further enhance our future growth prospects. In June 2006 we contracted with UTEK Corporation to improve our networking capabilities within research establishments and to support our own research into new technologies that may be employed in future products.

FINANCIAL AND OPERATING PERFORMANCE

Turnover for the period was up 39% at £3.3m (2005: £2.4m). As previously announced, the final result for the year to 31 March 2006 was adversely affected by delays to major contracts with the UK and US Governments that were largely due to factors outside of our control. On 28 September 2006, we confirmed that the US Government contract had been received and invoiced in full during the first half year. We also notified that the UK Government contract had been restructured and was now expected to be invoiced in the second half of the year but as a result of the restructuring of the contract, we expect revenue to be somewhat higher than previously anticipated, helping to underpin the expectations for the full year.

Operating profit before exceptional items increased to £87,000 (2005: loss of £47,000) after absorbing the impact of a weakened US dollar exchange rate, the additional costs of being a public limited company incurred in the period of approximately £135,000 (2005: £nil) and a charge of £30,000 (2005: £nil) in relation to share options granted.

During the period, 72% (2005: 48%) of the Group's revenue was in US dollars, which is largely unmatched. On the 2006 volumes a weakening in the average US dollar exchange rate of 6 cents adversely impacted turnover and operating profit by £65,000 and £60,000 respectively.

Gross research and development investment was up 39% at £0.7m (2005: £0.5m).

Net funds fell during the period by £1.4m to £1.2m with an underlying cash outflow from operations before exceptional items of £1.1m (2005: £0.5m). Trade debtors at the period end were £3.0m (2005: £1.5m) reflecting the timing of certain deliveries late in the period. At the date of approving these interim statements, approximately £2.0m of this amount has been collected.

BOARD

The business strengthened its Board with the appointments of Grant Ashley as Non Executive Director on 6 June 2006 and Stephen Ayres as Finance Director on 2 October 2006. Grant was previously executive assistant director of the FBI and brings substantial experience and knowledge to assist us in the development of our US and international operations. Stephen brings significant expertise in both corporate development and financial and operational management. Stephen succeeds James Cooke who remains on the Board as a Non Executive Director providing the Board with the benefit of his extensive experience of the business. Rob Cohen resigned from the Board on 17 November 2006 and on behalf of the Board I would like to record our appreciation for his significant efforts over the last seven years.

CURRENT TRADING AND OUTLOOK

The Company's business is more second half weighted reflecting the budgeting and procurement cycles of our major customers. Since the period end, trading has continued in line with management expectations and the Board looks forward with confidence to the second half of the year.

We will continue investing in our consistent growth strategy of new product development and increasing sales activity whilst researching potential acquisition opportunities.



PAUL LEVER
CHAIRMAN

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

	Note	Six months to 30 September 2006 (unaudited) £'000	Six months to 30 September 2005 before exceptional items (unaudited) £'000	Six months to 30 September 2005 exceptional items (unaudited) £'000	Six months to 30 September 2005 (unaudited) £'000	Year ended 31 March 2006 (audited) £'000
Turnover	2	3,382	2,435	—	2,435	7,308
Cost of sales		(2,001)	(1,409)	—	(1,409)	(3,546)
Gross profit		1,381	1,026	—	1,026	3,762
Distribution costs		(456)	(474)	—	(474)	(1,061)
Administrative expenses	3	(838)	(599)	(1,902)	(2,501)	(3,353)
Operating profit/(loss)		87	(47)	(1,902)	(1,949)	(652)
Interest receivable		40	24	—	24	75
Interest payable		(7)	(7)	—	(7)	(17)
Profit/(loss) on ordinary activities before taxation		120	(30)	(1,902)	(1,932)	(594)
Tax on profit/(loss) on ordinary activities	4	52	17	390	407	93
Profit/(loss) on ordinary activities after taxation		172	(13)	(1,512)	(1,525)	(501)
Basic earnings/(loss) per share	6	1.2p	(0.1)p	(14.9)p	(15.0)p	(3.6)p
Diluted earnings/(loss) per share	6	1.2p	(0.1)p	(14.9)p	(15.0)p	(3.6)p

CONSOLIDATED BALANCE SHEET AS AT 30 SEPTEMBER 2006

	Note	30 September 2006 (unaudited) £'000	30 September 2005 (unaudited) £'000	31 March 2006 (audited) £'000
Fixed assets				
Tangible assets		1,610	1,218	1,379
Current assets				
Stocks		1,200	977	1,205
Debtors		4,473	2,041	3,036
Cash at bank and in hand		1,361	1,454	2,789
		7,034	4,472	7,030
Creditors: amounts falling due within one year		(1,357)	(4,066)	(1,286)
Net current assets		5,677	406	5,744
Total assets less current liabilities		7,287	1,624	7,123
Creditors amounts falling due after more than one year		(166)	(188)	(177)
Net assets		7,121	1,436	6,946
Capital and reserves				
Called up share capital	7	69	56	69
Share premium account	7	4,468	1,147	4,468
Profit and loss account – normal	7	2,584	1,385	2,409
– EBT reserve	7	–	(1,152)	–
– total	7	2,584	233	2,409
Shareholders' funds – equity interests		7,121	1,436	6,946

CONSOLIDATED CASH FLOW STATEMENT FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

	Note	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Net cash outflow from operating activities	8	(1,114)	(685)	(102)
Return on investments and servicing of finance	9	33	17	58
Taxation received/(paid)	9	31	8	(565)
Capital expenditure and financial investment	9	(366)	(229)	(527)
Equity dividends paid	9	—	(600)	(600)
Cash outflow before financing		(1,416)	(1,489)	(1,736)
Financing				
(Decrease)/increase in financing	9	(12)	1,148	2,730
(Decrease)/increase in cash in the period		(1,428)	(341)	994

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	Note	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
(Decrease)/increase in cash in the period		(1,428)	(341)	994
Cash outflow/(inflow) from decrease/(increase) in debt		12	(1,148)	15
Changes in net debt resulting from cash flows	10	(1,416)	(1,489)	1,009
Movement in net funds in the period		(1,416)	(1,489)	1,009
Net funds at start of the period		2,584	1,575	1,575
Net funds at end of the period	10	1,168	86	2,584

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Profit /(loss) for the period	172	(1,525)	(501)
Exchange differences	3	2	2
Total recognised gains/(losses) for the period	175	(1,523)	(499)

RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Profit/(loss) on ordinary activities for the financial period	172	(1,525)	(501)
Dividends paid	—	(600)	(600)
Issue of ordinary shares	—	1,152	4,652
Issue costs of ordinary shares	—	—	(166)
EBT reserve	—	(1,152)	—
Exchange differences	3	2	2
Net addition/(reduction) to shareholders' funds	175	(2,123)	3,387
Opening shareholders' funds	6,946	3,559	3,559
Closing shareholders' funds	7,121	1,436	6,946

NOTES TO THE UNAUDITED REPORT AND ACCOUNTS

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

1 BASIS OF PREPARATION

These interim statements have been prepared in accordance with the accounting policies set out in the audited financial statements for the year ended 31 March 2006. The Interim Report and Accounts were approved by the Board on 30 November 2006. The results for the six months ended 30 September 2006 and 30 September 2005 have not been audited and do not constitute audited accounts within the meaning of the Companies Act 1985. The abridged financial information for the year ended 31 March 2006 has been extracted from the 2006 Annual Financial Statements which has been filed with the Registrar of Companies and on which the auditors reported without qualification.

2 SEGMENTAL INFORMATION

The turnover attributable to each of the group's geographical markets is:

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
United Kingdom	622	1,019	2,689
Europe	330	178	986
USA	2,430	1,178	2,643
Rest of World	—	60	990
	3,382	2,435	7,308

In the opinion of the directors the turnover, result for the period and net assets are attributable to one class of business. The directors do not believe that an analysis of results and net assets by reference to geographical markets would be appropriate.

3 ADMINISTRATIVE EXPENSES

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Ordinary administrative expenses	838	599	1,464
Exceptional items (see below)	—	1,902	1,889
Total administrative expenses	838	2,501	3,353
Exceptional items			
Issue of shares to management prior to Admission	—	1,300	1,300
Listing expenses	—	602	589
	—	1,902	1,889

3 ADMINISTRATIVE EXPENSES CONTINUED

The exceptional item is made up of two elements:

- Obligation arising from previous owners to management team of £1,300,000

The previous 100% shareholder of Datong had an undertaking to provide the executive management shares in consideration for performance while the Company was under its ownership. Consequently 900,000 shares were issued on 30 September 2005 at a cost to the Company of £1,300,000.

- Listing expenses of £589,000

The listing expenses of £589,000 contain expenses relating to the Admission of the Company to AIM.

4 TAXATION

The tax credit for the period has been calculated at the estimated effective rate for the full year expressed as a percentage of the expected results for the year and then applied to the interim results.

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Corporation tax – current	(50)	(399)	(50)
– prior year	9	–	–
	(41)	(399)	(50)
Foreign tax – current	36	–	(30)
– prior year	4	(8)	(7)
	40	(8)	(37)
	(1)	(407)	(87)
Deferred tax	(51)	–	(6)
Total tax credit	(52)	(407)	(93)

NOTES TO THE UNAUDITED REPORT AND ACCOUNTS CONTINUED

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

5 DIVIDEND

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Special dividend	—	600	600

No interim dividend is proposed for the period.

On 7 September 2005 a special dividend of £1,000 per share (of which there were 600 at the time) was declared and then paid on 30 September 2005.

6 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period. An adjusted earnings per share has been presented to show the trading performance of the business before exceptional items. The diluted earnings per share is after taking into account the dilutive effect of share options.

	Six months to 30 September 2006 (Unaudited)	Six months to 30 September 2005 (Unaudited)	Year ended 31 March 2006 (Audited)
Number of shares issued	13,834,375	11,100,000	13,834,375
Less shares held by EBT	—	(900,000)	—
Basic number of shares	13,834,375	10,200,000	13,834,375
Add: maximum dilution from share options	374,600	—	258,800
Diluted number of shares	14,208,975	10,200,000	14,093,175
	£'000	£'000	£'000
Profit/(loss) on ordinary activities after taxation	172	(1,525)	(501)
Exceptional items after tax	—	1,512	1,499
Adjusted profit/(loss)	172	(13)	998
Basic earnings/(loss) per share	1.2p	(15.0)p	(3.6)p
Basic earnings/(loss) per share before exceptional items	1.2p	(0.1)p	7.2p
Fully diluted earnings/(loss) per share	1.2p	(15.0)p	(3.6)p
Fully diluted earnings/(loss) per share before exceptional items	1.2p	(0.1)p	7.1p

7 SHARE CAPITAL AND RESERVES

	Six months to 30 September 2006 (Unaudited)	Six months to 30 September 2005 (Unaudited)	Year ended 31 March 2006 (Audited)
Authorised			
Number of shares	200,000,000	200,000,000	200,000,000
Nominal value – 0.5p each	£1,000,000	£1,000,000	£1,000,000
Allotted, called up and fully paid			
Number of shares	13,834,375	11,100,000	13,834,375
Nominal value – 0.5p each	£69,172	£55,500	£69,172

SHAREHOLDERS' FUNDS – EQUITY INTEREST

	Share capital £'000	Share premium £'000	Profit and loss £'000	Total £'000
As at 1 April 2005	1	—	3,558	3,559
Capitalisation of profit and loss reserve	50	—	(50)	—
Issue of 3,634,375 shares at £1.28 each	18	4,634	—	4,652
Placing commission	—	(166)	—	(166)
Loss for the year to 31 March 2006	—	—	(501)	(501)
Dividends paid	—	—	(600)	(600)
Exchange difference	—	—	2	2
As at 31 March 2006	69	4,468	2,409	6,946
Profit for six months to 30 September 2006	—	—	172	172
Exchange difference	—	—	3	3
As at 30 September 2006	69	4,468	2,584	7,121

NOTES TO THE UNAUDITED REPORT AND ACCOUNTS CONTINUED

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

8 RECONCILIATION OF OPERATING PROFIT TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Operating profit/(loss) after exceptional items	87	(1,949)	(652)
Exceptional items			
Issue of shares to management	—	1,300	1,300
Listing expenses deducted from gross funds raised	—	602	589
Operating profit/(loss) before exceptional items	87	(47)	1,237
Depreciation	135	115	249
Exchange differences	—	(1)	(3)
Profit/(loss) on disposal of fixed assets	—	—	(1)
(Increase)/decrease in debtors	(1,414)	29	(1,116)
Increase/(decrease) in creditors	73	(625)	(89)
Decrease/(increase) in stock	5	(8)	(236)
Net cash outflow from operating activities before exceptional items	(1,114)	(537)	41
Employers National Insurance paid on issue of shares to management	—	(148)	(143)
Net cash outflow from operating activities	(1,114)	(685)	(102)

9 ANALYSIS OF CASH FLOWS

	Six months to 30 September 2006 (Unaudited) £'000	Six months to 30 September 2005 (Unaudited) £'000	Year ended 31 March 2006 (Audited) £'000
Returns on investments			
Interest received	40	24	75
Interest element of finance lease rental payments	(1)	(1)	(1)
Interest paid	(6)	(6)	(16)
	33	17	58
Taxation			
Corporation tax (paid)/refund	31	8	(565)
Capital expenditure and financial investment			
Purchase of tangible fixed assets	366	234	531
Receipts from disposal of fixed assets	—	(5)	(4)
	366	229	527
Equity dividends paid			
Equity dividend paid	—	600	600
Financing			
Gross proceeds raised at Admission to AIM	—	—	3,500
Less: Admission related expenses	—	—	(589)
Less: Placing expenses	—	—	(166)
Net cash raised	—	—	2,745
Loan finance raised	—	1,152	1,152
Receipt of hire purchase loan	—	16	16
Loan finance repaid	—	—	(1,152)
Repayment of capital element of hire purchase	(4)	(7)	(11)
Repayment of loans	(8)	(13)	(20)
	(12)	1,148	2,730

NOTES TO THE UNAUDITED REPORT AND ACCOUNTS CONTINUED

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006

10 ANALYSIS OF NET FUNDS

	At 1 April 2006 £'000	Cash Flow £'000	At 30 September 2006 £'000
Cash in hand and at bank	2,789	(1,428)	1,361
Debt due within one year	(20)	(1)	(21)
Debt due after one year	(165)	9	(156)
Finance leases	(20)	4	(16)
Total	2,584	(1,416)	1,168

INDEPENDENT REVIEW REPORT BY KPMG AUDIT PLC TO DATONG ELECTRONICS PLC

INTRODUCTION

We have been engaged by the Company to review the financial information set out on pages 4 to 14 and we have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the company in accordance with the terms of our engagement. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this 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 for our review work, for this report, or for the conclusions we have reached.

DIRECTORS' RESPONSIBILITIES

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the AIM Rules which require that the interim report must be presented and prepared in a form consistent with that which will be adopted in the Company's annual accounts having regard to the accounting standards applicable to such annual accounts.

REVIEW WORK PERFORMED

We conducted our review having regard to the guidance contained in Bulletin 1999/4: Review of interim financial information issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

REVIEW CONCLUSION

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 September 2006.

KPMG AUDIT PLC
CHARTERED ACCOUNTANTS
1 THE EMBANKMENT
NEVILLE STREET
LEEDS LS1 4DW
30 NOVEMBER 2006

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DIRECTORS, SECRETARY AND ADVISERS

PAUL LEVER
NON-EXECUTIVE CHAIRMAN

STEPHEN AYRES
FINANCE DIRECTOR
APPOINTED 2 OCTOBER 2006

GRANT ASHLEY
NON-EXECUTIVE DIRECTOR
APPOINTED 6 JUNE 2006

BRIAN SMITH
CHIEF EXECUTIVE OFFICER

JAMES COOKE
NON-EXECUTIVE DIRECTOR

COMPANY SECRETARY

STEPHEN AYRES
APPOINTED 2 OCTOBER 2006

ADVISERS

**NOMINATED ADVISER
AND BROKER**
Bridgewell Limited
Old Change House
128 Queen Victoria Street
London EC4V 4BJ

REGISTRARS
Capita Registrars
Northern House
Woodsome Park
Fenay Bridge
Huddersfield HD8 0LA

REGISTERED OFFICE
Clayton Wood Close
West Park
Leeds LS16 6QE

AUDITORS
KPMG Audit plc
1 The Embankment
Neville Street
Leeds LS1 4DW

FINANCIAL PR
Smithfield Group
10 Aldersgate Street
London EC1A 4HJ

designed and produced by

**the design portfolio
marketing services.**

a member of the flatfish communications group plc

www.design-portfolio.co.uk

Datong Electronics plc
Park House
Clayton Wood Close
West Park
Leeds LS16 6QE

Tel: 0113 274 4822
Fax: 0113 274 2872
Email: ir@datong.co.uk
Web: www.datong.co.uk