

24 August 2007

Telephonetics Plc
Unaudited interim results
For the six months to 31 May 2007

Telephonetics Plc ('the Company' or 'the Group'), a leading provider of hosted and customer premises speech recognition and voice automation solutions, has today announced its interim results for the six months ended 31 May 2007.

Highlights

- Unaudited revenues for the half-year up 97% to £4.8 million.
- Unaudited adjusted profit before taxation¹ down 58% to £155,000.
- Maintenance revenues for the half-year now accounting for £1.6 million, from 540 deployments, compared with 50 last year.
- Healthier business mix with MovieLine[®] accounting for 39% of sales compared with 76% last year.
- Greater investment in sales, marketing and development, up from £0.4 million to £1.9 million.
- Gross margins improved from 52% to 59%.
- Reduced administrative expenses¹ as a percentage of sales: 18% compared to 22% last year.
- Cash levels increased by £259,000 since 30 November 2006 to £3.3 million.
- Launch of new products, including speaker verification.

Mike Neville, Chairman of Telephonetics, commented:

"I am pleased to report that trading in the first half was in line with our expectations. The Company continues to push forward and has won a number of excellent contracts. Over the first half Telephonetics has become a more solid business proposition, with a long-term strategy in place that includes greater investment in our sales, marketing and development teams, as well as successfully diversifying our revenue streams. It has taken a little longer than initially anticipated to see the investment benefits emerge, however we strongly believe the Company is on a firm footing.

"All indicators show that the outlook for the speech market remains positive and we believe that the Company is well positioned to benefit from the sector's future growth."

- Ends -

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¹ before intangible asset amortisation and exceptional items

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Business Review

During the six months to 31 May 2007, unaudited revenues increased 97% to £4.8 million (2006: £2.4 million). Adjusted profit before tax¹ was down 58% to £155,000 (2006: £368,000), reflecting the greater investment in product marketing and development, and an expansion of the sales force. The Group has seen a number of contract wins for the supply of speech solutions, as well as maintaining performance from MovieLine[®], the film booking and information Advanced Speech Recognition ('ASR') service.

Gross margins were improved to 59%, compared with 52% last year, as a result of higher margin maintenance work, constituting a greater proportion of revenue, and combined with the realisation of certain supply chain and service efficiencies.

System sales & professional services

The sales of our speech recognition systems and associated services, covering the corporate, health and public sectors, increased by £899,000 to £1.328 million. This included significant contract wins, such as those recently announced with Kenwood/DeLonghi and New Forest District Council. We also continued to secure orders for deployments of speech solutions into our base, including Hertfordshire County Council and Royal Hospital Bath NHS Trust, both of whom have deployed large scale speech solutions.

The Group has continued to strengthen its position in the health service, with new contracts for our automated appointment bookings service and growing demand for automation of test results. The latter has generated a solution-sale per month. The Group has also made some progress into other sectors, such as Retail and Finance.

Maintenance

Maintenance revenues have become increasingly important to the business mix, with revenues up by £1.434 million to £1.578 million. This was the result of new speech system sales, the acquisition of VIP's customer base in July 2006, and expanded service offerings. The installed base now consists of 540 deployments, compared with 50 in 2006. These provide a significant stream of contracted revenues to take forward into future financial periods.

MovieLINE[®]

MovieLine[®] increased revenues to £1.882 million, which was in line with the Company's expectations, and is a 1% increase on last year's £1.858 million. A decrease in call volumes over the platform of 6% to 14.9 million minutes was offset by improved telecoms rates and other service fees.

Product development

Over the past six months, investment in product marketing and development has almost doubled to £416,000 from £209,000.

Portfolio products have been enhanced to ensure they retain their current strong position in the market. Examples include the addition of speech call steering into the Automatic Call Distributor (ACD) offering, network-based Interactive Voice Response

(IVR) extensions and the release of DialogueBuilder. The latter provides for more rapid design and deployment of call handling solutions, including the seamless integration of speech into the call flow.

New products have been released centred on the Automation Agent model, aimed primarily at service automation. Examples include automation of payment requests and information provision. Speech plays an important role within this product stream, allowing a broad range of requirements to be addressed. In particular, core speaker verification technology now allows full automation of caller authentication.

Our new Mass Outbound Solution provides a highly scalable and resilient outbound capability enabling rapid message delivery to vast numbers of recipients. Call to action and associated response criteria can be tailored to meet virtually any requirement. The solution is flexible enough to satisfy customer demands, ranging from emergency notification and command and control, through to client interaction in the financial services space.

Sales and marketing costs

As announced earlier this year, the Group has increased the size of its sales and marketing operations, which coupled with the full year impact of the VIP acquisition, has increased average staff numbers in these functions to 38 compared to 7 this time last year. This has led to increased expenditure on sales and marketing to £1.531 million (2006: £234,000), and substantially increased the scope and capability of our sales focus.

EBITDA and Cash Flow

EBITDA before exceptional items remained positive at £312,000 (2006: £410,000) despite the significant investments in sales and marketing and product and development as noted above.

This positive EBITDA translated into an increase in net cash of £259,000 to £3.3 million from the position at the year-end.

Administrative expenses

As anticipated, administrative expenses before intangible asset amortisation and exceptional items have increased to £865,000 (2006: £542,000). This is a result of our investment in finance, human resources and management functions in July 2006, primarily to support the expanding business following the acquisition of VIP. Expense growth was controlled and has reduced as a percentage of sales from 22% last year to 18%. Ongoing efficiencies have been achieved resulting in cost savings of £111,000, or 11%, when compared with the second half of 2006.

Outlook

The speech recognition market remains resilient. More organisations are deploying solutions in order to meet the increasing demands placed upon their businesses for provision of services, whilst at the same time minimising costs and enhancing customer satisfaction. Successful speech deployments provide these additional services, across a 24-hour timeframe, reducing the dependency on live operators and contact centre agents. This allows skilled staff to handle those calls where they can actually add value. The market for network-based speech solutions in EMEA, which includes speaker verification, is estimated to grow to £400 million by 2010 (*source: Datamonitor*).

The Board believes that Telephonetics is well positioned to benefit from the sector's forecast growth by continuing to target new areas and exploit current products, as well as look to benefit from new products coming on-line. Through the next twelve months, we should start to see the greater investment in sales and marketing

paying-off and coming through into the top-line numbers. This is backed up by a number of exciting opportunities already in the pipeline. Although the time from joining the sales team to generation of orders has proved longer than expected, which will have an impact on the full year revenues, we anticipate that the profit before tax for the whole period will be unaffected due to the improved margins and operational efficiencies currently being achieved.

We remain confident in the future, but as always, the full year results remain dependent on the timing of orders and implementation.

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Consolidated profit and loss account for the six months ended 31 May 2007

	Note	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited* £'000	Year ended 30 Nov 2006 audited* £'000
Turnover		4,800	2,432	6,512
Cost of sales		(1,953)	(1,160)	(2,809)
Gross profit		2,847	1,272	3,703
Operating expenses	3	(3,542)	(1,022)	(4,124)
Operating (loss)/ profit		(695)	250	(421)
Operating (loss)/ profit analysed as:				
Operating profit pre-exceptional items and goodwill amortisation	3	87	307	458
Goodwill amortisation	3	(550)	-	(458)
Exceptional acquisition and restructuring costs	3	(147)	-	(295)
Exceptional share option expenses		(85)	(57)	(126)
		(695)	250	(421)
Interest receivable		55	54	108
Interest payable		(1)	(1)	(3)
(Loss)/ profit on ordinary activities before taxation		(641)	303	(316)
Taxation on (loss)/ profit on ordinary activities		(4)	(62)	92
(Loss)/ profit on ordinary activities after taxation		(645)	241	(224)
Loss)/ earnings per share (pence)				
Basic	4	(0.60)	0.43	(0.29)

The profit and loss account contains all recognised gain and losses for the period and preceding periods.

* As restated - see note 2.

Consolidated balance sheet as at 31 May 2007

	Note	31 May 2007 unaudited	31 May 2006 unaudited*	30 Nov 2006 audited*
		£'000	£'000	£'000
Fixed assets				
Intangible assets		10,086	49	10,598
Tangible assets		721	608	868
		10,807	657	11,466
Current assets				
Stock		299	52	289
Debtors		2,730	1,211	1,749
Cash at bank and in hand		3,308	3,427	3,049
		6,337	4,690	5,087
Creditors: amounts falling due in 1 year		(3,863)	(1,915)	(3,165)
Net current assets		2,474	2,775	1,922
Total assets less current liabilities		13,281	3,432	13,388
Creditors: amounts falling due after 1 year		(530)	(104)	(216)
Provisions for liabilities and charges		(238)	(50)	(110)
Net assets		12,513	3,278	13,062
Capital and reserves				
Called up share capital	5	1,090	566	1,083
Share premium account	5	6,802	2,088	6,798
Reverse acquisition reserve	5	506	506	506
Merger reserve	5	4,951	-	4,951
Profit and loss account	5	(836)	118	(276)
Shareholders' funds	5	12,513	3,278	13,062

* As restated - see note 2.

Consolidated cash flow statement for the six months ended 31 May 2007

	Note	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited £'000	Year ended 30 Nov 2006 audited £'000
Net cash inflow from operating activities	6	311	660	644
Returns on investment and servicing of finance:				
Interest received		55	54	108
Interest paid		(1)	(1)	(3)
Net cash inflow from returns on investment and servicing of financing		54	53	105
Taxation		-	-	(52)
Capital expenditure and financial investment:				
Payments to acquire tangible fixed assets		(65)	(110)	(231)
Payments to acquire intangible fixed assets		(52)	(15)	(41)
Net cash outflow from capital expenditure and financial investment		(117)	(125)	(272)
Acquisition and disposals:				
Acquisition of subsidiary undertaking		-	-	(6,349)
Cash received with acquisition		-	-	1,156
Net cash outflow from acquisitions and disposals		-	-	(5,193)
Cash inflow before financing		248	588	(4,768)
Financing:				
Issue of ordinary shares		-	-	5,250
Expenses paid in connection with share issue		-	-	(284)
Proceeds from exercise of share options		11	5	17
Cash inflow from financing		11	5	4,983
Increase in cash		259	593	215

Notes to the interim results

1. Basis of preparation

For the purposes of Section 240 of the Companies Act 1985:

(a) this interim report does not constitute a set of statutory accounts. The interim financial information has been prepared on the basis of the accounting policies which were applied in preparation of the annual financial statements to 30 November 2006 with the exception of the accounting for share options. FRS 20 "Share Based Payments" is applicable for the first time and has resulted in a prior year restatement which is detailed below.

(b) Statutory accounts in respect of the year to 30 November 2006 have been delivered to the Registrar of Companies and those accounts were subject to an unqualified report by the Auditors. Accounts for the six month period ended 31 May 2007 and 31 May 2006 have not been audited nor delivered to the Registrar of Companies.

The results for the six months ended 31 May 2007 were approved by the Board on 23 August 2007 and are available on the Company's web site www.telephonetics.co.uk from 28 August 2007.

2. Implementation of FRS 20 'Share based payments'

The Group has applied the requirements of FRS 20 "Share-Based Payments". In accordance with the transitional provisions, FRS 20 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 December 2005.

The Group issues equity-settled share based payments to certain employees and directors. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest.

Fair value is measured by use of a Black-Scholes or Monte Carlo models as appropriate. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. A liability equal to the portion of goods or services received is recognised at the current fair value determined at each balance sheet date for cash-settled share-based payments.

The effect of this change in accounting policy on the reported profit and loss has been an increase in general & administrative expense of £57,000 in the six months ended 31 May 2007; £47,000 for the six months ended 31 May 2006; and £89,000 for the year ended 30 November 2006 and a reduction in the tax charge of £6,000 in the six months ended 31 May 2007; £18,000 for the six months ended 31 May 2006; and £30,000 for the year ended 30 November 2006 as a result of the deferred tax asset arising on the FRS 20 charge. The impact on net assets was an increase of £33,000 at 30 November 2006 and £23,000 at 31 May 2006.

3. Operating expenses

	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited* £'000	Year ended 30 Nov 2006 audited* £'000
Operating expenses are analysed as:			
Research & development	364	189	496
Sales & marketing	1,531	234	1,231
General & administration	1,647	599	2,397
Analysed as:			
General & administration before exceptional items and goodwill amortisation	865	542	1,518
Goodwill amortisation	550	-	458
Exceptional restructuring and acquisition expenses	147	-	295
Exceptional share option expenses	85	57	126
	1,647	599	2,397
	3,542	1,022	4,124

* As restated - see note 2.

Exceptional items within operating profit are:

With the acquisition of Voice Integrated Products Ltd in 2006 the Group inherited a number of leasehold properties in Poole. As part of the post acquisition integration on 1 April 2007 the Group vacated a number of these premises and a provision of £147,000 has been made for the residual lease commitments, together with outgoings, after taking into account management's estimate of possible sub-let income.

In 2006, the Company incurred £295,000 of expenses in relation to the acquisition of Voice Integrated Products Ltd in July 2006 and its subsequent restructuring. Expenses included professional fees in connection with the pre-acquisition investigation and post-acquisition restructuring of £91,000, redundancy costs of £119,000 and transaction related emoluments of £85,000 (which are included in staff costs).

4. Earnings per share

Earnings per ordinary share have been calculated using the weighted average number of shares in issue during the relevant financial period and earnings, being profit/(loss) after tax and minority interests.

	Note	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited* £'000	Year ended 30 Nov 2006 audited* £'000
Reconciliation of (loss)/ earnings:				
(Loss)/ earnings used for calculation of basic and diluted earnings per share		(645)	241	(224)
Goodwill amortisation	3	550	-	458
Exceptional acquisition and restructuring costs	3	147	-	295
Exceptional share option expense	3	85	57	126
Earnings used for calculation of adjusted basic and diluted earnings per share		137	298	655

* As restated - see note 2.

		6 months ended 31 May 2007 unaudited Number	6 months ended 31 May 2006 unaudited Number	Year ended 30 Nov 2006 audited Number
Reconciliation of denominator:				
Shares used for calculation of basic and diluted earnings per share		108,380,259	56,506,117	77,736,627
Exercise of share options		6,716,379	4,916,758	4,855,354
Shares used in calculation of diluted and adjusted earnings per share		115,096,637	61,422,875	82,591,981

5. Reconciliation of movement in shareholders' funds

	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited (restated) £'000	Year ended 30 Nov 2006 audited (restated) £'000
(Loss)/ profit for the financial period	(645)	241	(224)
New shares issued	11	5	5,232
Credit for share option expenses	85	62	133
Merger reserve arising on acquisition of subsidiary undertaking	-	-	4,951
Net addition to shareholders' funds	(549)	308	10,092
Opening shareholders' funds	13,062	2,970	2,970
Closing shareholders' funds	12,513	3,278	13,062

6. Net cash inflow from operating activities

	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited £'000	Year ended 30 Nov 2006 audited £'000
Operating (loss)/ profit	(695)	250	(421)
Depreciation charge	211	95	263
Intangible asset amortisation charge	14	8	20
Loss on disposal	-	-	1
Goodwill amortisation	550	-	458
Exceptional share option expense	85	62	133
Decrease/ (Increase) in stock	(9)	57	113
Decrease/ (Increase) in debtors	(991)	68	802
Increase in creditors	1,146	120	(725)
Net cash inflow from operating activities	311	660	644

8. Reconciliation of non-statutory figures

Reconciliation of operating (loss)/ profit to EBITDA before exceptional items:

	Note	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited £'000	Year ended 30 Nov 2006 audited £'000
Operating (loss)/ profit		(695)	250	(421)
Exceptional share based payments		85	57	126
Exceptional restructuring and acquisition costs	3	147	-	295
Depreciation		211	95	263
Loss on disposal of tangible fixed assets		-	-	1
Amortisation of intangible fixed assets		14	8	20
Goodwill amortisation		550	-	458
EBITDA pre-exceptional items		312	410	742

Reconciliation of loss before tax to profit before tax, intangible asset amortisation and exceptional items:

	Note	6 months ended 31 May 2007 unaudited £'000	6 months ended 31 May 2006 unaudited £'000	Year ended 30 Nov 2006 audited £'000
(Loss)/ profit before tax		(641)	303	(316)
Exceptional share based payments		85	57	126
Exceptional restructuring and acquisition costs	3	147	-	295
Amortisation of intangible fixed assets		14	8	20
Goodwill amortisation		550	-	458
Profit before tax, intangible asset amortisation and exceptional items		155	368	583