



INSPIRING YOUR PRODUCTS AND MANUFACTURING
Interim Report 2007

WHAT WE DO AT A GLANCE

MARKING

The production of equipment to produce permanent marking on a wide range of products. Examples include consumer electronics, semi-conductor, automotive and aerospace.



MEDICAL

A growing range of aesthetic laser applications such as skin resurfacing and rejuvenation.



MICRO

A term for a diverse set of applications that require fine or precise cutting or welding. These include medical components (eg stents), electronic assembly, printing etc.



MACRO

Cutting and welding of larger parts in industries such as automotive, white goods, etc.



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CORPORATE STATEMENT

Our goal is to be a leader in the optical fibre-based laser market.

SPI is now a recognised leader in the design and manufacture of fibre lasers. The Group's technology is rapidly becoming an integral part of producing many end-user products by improving, and in some cases enabling, its customers' manufacturing processes. SPI continues to expand the applications space for fibre lasers, with powers from mWs to kW.

HIGHLIGHTS

- ➔ Turnover of £7.2 million (H1 2006: £3.0 million), equalling full year revenues for 2006
- ➔ Product revenue of £6.4 million, 253% growth over H1 2006 (£1.8 million)
- ➔ Gross loss of £0.7 million (H1 2006: £1.0 million)
- ➔ Loss after taxation £5.3 million (H1 2006: £4.6 million)
- ➔ New product introductions in the MICRO, MARKING and MEDICAL sectors are now shipping in volume
- ➔ Growth is being achieved in all our markets and geographies particularly in the MEDICAL sector in Asia
- ➔ Significant progress in design of low-cost platforms which will be introduced at the end of the year leading to improved gross margin and allow business simplification
- ➔ Growth is being predominantly driven by newer product lines, which are earlier in their life cycles and hence not yet fully cost-reduced
- ➔ Number of customer accounts has increased by 36% since December 2006 and has now reached 190
- ➔ Placing of 5.25 million new shares in February 2007, raising £10.1 million net of expenses
- ➔ Further to 21 August 2007 trading update, the Group will require additional funding prior to the end of this financial year to meet its working capital requirements and is making good progress in discussions to attract the necessary funding from a variety of sources

CHAIRMAN'S STATEMENT

As stated in the Annual Report for 2006 in March, SPI's core task for 2007 is achieving the effective scaling up of its production at lower costs. The Group generally made good headway in that two-fold pursuit during the first six months of the financial year.

Revenues for the first six months of 2007 equalled the full year revenues for 2006, due entirely to an increase of three-and-a-half times in product sales over those achieved in the first half of last year. However, despite a recent major contract win for UK Ministry of Defence work, which will improve contract revenues in 2008, contract revenues declined first half on first half by some 34%, due to contract phasing and the redeployment of engineering resources to support the rapid growth in product sales.

Some progress was also made towards SPI's target of lowering production costs. However, earlier market expectations that a small positive gross profit margin would be achieved for the first half of 2007 were impacted by delays in cost reduction programmes relating to existing products and a shift in the mix of sales towards newer product releases where cost reduction had yet to be implemented.

FINANCING

In February 2007, SPI completed an equity fundraising of £10.1 million (net) through the issue of 5.25 million shares at 200p each.

Following the trading update of 21 August 2007, where SPI announced that trading was being impacted by a number of external and internal issues including the weak US Dollar, the pricing environment within its laser markets, and some supplier delays, the Group commenced examining various sources of additional funding. This additional financing will be required to meet working capital requirements prior to the end of this financial year to ensure the Group remains a going concern, as well as to provide the necessary funds for the continued growth of the business. Whilst a significant uncertainty remains until the financing is completed, the Group is making good progress in its discussions to raise the required funds.

THE BOARD

On 10 July 2007 it was announced that Steve Berg, Chief Financial Officer, would be resigning at the end of September following publication of these Interim Results. The Board would like to acknowledge and thank Steve for his considerable contribution to SPI Lasers since 2003.

On 13 September 2007, the Group announced the appointment of David Holloway as Chief Financial Officer with effect from 1 October 2007. David joined the Group on 17 September 2007 to facilitate an orderly handover.

OUTLOOK

With our current order book and pipeline we expect to deliver similar revenue in the second half to the first half of this year with product sales more than double those achieved in the second half of 2006.

As a result of further cost reduction initiatives already achieved or planned over the coming months, the Group should move to a position that produces a positive gross profit from operations for the first time before the end of this year and we are maintaining our goal to become profitable towards the end of 2008.

As noted above the raising of additional funding is integral to the continued operation and successful development of the business. The Group is making good progress in discussions to secure the required funds.

GRAHAM MEEK
CHAIRMAN
28 SEPTEMBER 2007

CHIEF EXECUTIVE'S REVIEW

INTRODUCTION

SPI's performance of the business in the first half of 2007 was solid with revenue, profit and cash either in line or ahead of market expectations. Strong order flow across the sectors was converted to sales and the Group moved forward on many of the operational challenges that were set at the beginning of the year: building an organisation that can deliver strong profitable growth in the future. During the summer months, however, we have observed an ever increasing dynamic of change in our markets which caused us to set revised expectations for the second half of the year and for 2008.

On review of the first half of 2007, it is obvious that SPI has reached a stage of increasing momentum. For example the Group's product sales increased by 253% with sales of £6.4 million versus £1.8 million over the same period last year.

MARKETS, CUSTOMERS AND CHANNEL

The laser industry is a large and established market. In the first half of 2007, fibre lasers continued to be more widely recognised as tools that deliver real advantages for a range of applications and many end users. SPI's successes to date as a supplier of industrial grade products are proof of this maturing process. The pre-eminent biannual trade show in June, Laser 2007, was further

evidence of this development with several notable product announcements. Whilst this increasing competitive environment is notable, the Group welcomes the validation and potential market expansion that this will yield.

SPI's customers are mainly system integrators building end user systems that incorporate its lasers as the optical source. In some cases these integrators are part of the end user entity, but in the majority of cases they are an intermediary. Consequently, SPI continues to invest heavily in creating awareness of the many advantages of fibre lasers in the end user community to create "pull through" in the sales channel and this strategy is continuing to be successful. There is also a trend towards a pricing model where the fibre laser approaches parity with conventional lasers hence reducing inertia at large integrators. This should again expand the market.

The Group continues to gain momentum in the MICRO sector. Of note is the further progress SPI made in penetrating the medical device manufacturing market, where the fibre laser's ability to cut and weld fine feature size items rapidly and with high quality has been a differentiator against traditional lasers. Initial successes were gained in stent cutting (a stent is a spring-like structure that is expanded within veins and arteries) leading

to a number of stent industry leaders now deploying SPI products and with the largest single deployment being in excess of 80 lasers. Having established the Group in this sub-sector, SPI is now engaged with a number of other customers and working on new applications in the medical component marketplace.

This reflects SPI's market approach: excel at an application and then drive penetration. Corresponding with the Group's growth, SPI has succeeded in adding further market verticals in automotive, consumer electronics and semiconductors. To support this, further investment has been made into channel resources, both direct and through specialist distribution partners, and established applications and support capabilities in the UK, the USA and, more recently, China.

Towards the end of 2006, we began shipping our pulsed laser products for the MARKING sector securing several supply contracts, and establishing a strong order book. Whilst this has been successful with a number of customers we have recently observed a phenomenon whereby reflected light from the work piece can be coupled back into the laser causing the laser to fail. This is due to a fault with an externally procured component known as an Optical Isolator. This is now rectified. It has, however, slowed the rate of design wins and ramp

CHIEF EXECUTIVE'S REVIEW

MARKETS, CUSTOMERS AND CHANNEL (CONTINUED)

up for the second half. We have also observed that the market has two quite distinct sub-sectors, the higher end applications and the volume basic marking sector. For higher end applications, SPI's laser is well suited in both performance and price to penetrate this sub-sector. The basic marking sector is more price sensitive, albeit with higher volumes, and so to be a major player in the MARKING sector, SPI will need to respond accordingly.

The MEDICAL AESTHETICS sector, wherein the fibre laser is used as a direct tool for cosmetic enhancement and correction, was very strong in the first half of 2007 contributing significantly to the Group's sales growth in Asia.

All of these activities are consistent with SPI's strategy of utilising its specialised optical fibre capability to establish a technology platform that can be sold into multiple markets. The Group continues to strive for products that deliver the end user benefits in performance and cost of ownership that industry watchers believe will fuel the rapid growth of fibre lasers.

The recently announced contract win to further develop our high power capability bodes well for future penetration in the MACRO sector.

OPERATIONAL

2007 started well with sales of the products introduced in 2005 and 2006 meeting the first half year market expectations of £5.8 million, representing 123% of the 2006 full year result.

In particular, the Group achieved volume shipments of its novel pulsed laser for the MARKING sector, which is designed to operate faster than the competitive offering. The technical issues appear to have been overcome. The challenge for the second half of 2007 will be to validate this with customers and to develop a lower cost platform for the more basic marking applications.

A major theme for this year has been, and continues to be, cost reduction. The basic laser platforms for all markets are being redesigned to allow material cost reduction and platform consolidation which is essential when SPI is to move towards profitability. This is an ongoing process and the magnitude and impact of this activity is certain to increase given the changes in the pricing dynamic outlined above. We have made major strides in this and are comfortable that our new platforms to be released in the later part of the year will have a major benefit in reducing both fixed and variable costs for FY08.

During 2007 there were a number of other initiatives designed to manage the growth of the Group in a more reliable and predictable manner. These included both human resource and infrastructure projects.

OUTLOOK AND KEY EVENTS

Despite the issues that resulted in a resetting of expectations in August 2007, the second half of 2007 will be broadly in line with the first half. Whilst we accept that there may be some unpredictability due to the rapidly changing external environment and the internal pressures associated with such rapid growth, the exciting challenge for the remainder of 2007 and beyond is to deliver on the increasing number of opportunities by developing new products and accelerating those already introduced, to take advantage of the expanding market and to do so whilst improving the cost structure of the business, as we move towards profitability.

DAVID PARKER
CHIEF EXECUTIVE OFFICER
28 SEPTEMBER 2007

FINANCIAL REVIEW

SALES

Total sales grew by 140% over the first half of 2006 to £7.2 million with an underlying product sales growth of 253%. Contract sales, which relate to SPI's USA and UK defence and aerospace development contracts, were 66% of equivalent revenues in the same period in 2006 due to contract phasing and resources being deployed to support the growth in product revenue.

Asia has become SPI's biggest market with 48% of total sales and 54% of product sales in the first half of 2007, up from 18% and 30% respectively in the first half of 2006. Sales in the UK accounted for only 10% of total sales in the first half of 2007, down from 23% in 2006, mainly due to the growth in exports and UK related contract phasing.

OPERATIONAL PERFORMANCE

Gross losses reduced by £0.3 million from £1.0 million (35% of sales) in the first half of 2006 to £0.7 million (10% of sales) in the first half of 2007 as a result of increased product volumes and after recognising investment costs in manufacturing capacity, logistics and systems in response to the volume growth. Expectations that a gross profit margin of 3% would be achieved for the first half of 2007 were impacted by delays in cost reduction programmes relating to earlier

release products and a shift in the mix of sales towards newer product releases where cost reduction had yet to be implemented.

The reduction in gross losses was offset, however, by increases in product research and development £0.4 million, sales and marketing £0.2 million, share-based payment charges £0.3 million and other expenses £0.2 million. The net result was an increase in the loss before taxation of £0.8 million to £5.5 million from £4.7 million in 2006.

Group funded product research and development, referred to above, was £1.4 million. However, in addition, and charged against cost of sales, the Group spent £0.7 million on customer funded R&D. The total incurred investment in R&D was therefore £2.1 million, an increase of 11% over the £1.9 million equivalent spend in 2006.

TAXATION

SPI has an unrecognised deferred tax asset of £14.3 million, which has primarily arisen from the losses incurred to date. In the first half of 2007, an R&D tax credit of £0.2 million (£0.2 million in 2006) was recognised; the associated cash receipt from HM Revenues & Customs is expected to be received in the first half of 2008 (the 2006 related tax credit is expected to be received in the second half of 2007).

LOSS AFTER TAXATION

The loss after taxation for the first half of 2007 was £5.3 million, an increase of £0.7 million over the first half of 2006 of £4.6 million. This is primarily due to the issues referred to above in operational performance.

DIVIDEND

The directors do not propose to pay an interim dividend (2006: nil).

HEADCOUNT

Average heads increased from 109 in the first half of 2006 to 167 in the first half of 2007 due to investment in manufacturing, logistics, engineering and sales. Annualised sales increased from £55,000 per head in the first half of 2006 to £86,000 per head in the first half of 2007 and the annualised loss after tax for 2006 and 2007 reduced from £84,000 per head to £64,000 per head respectively.

FIXED ASSETS

Gross fixed assets grew by £0.4 million during the first half of 2007, an increase of 3% on the balance as at 31 December 2006. This expenditure mainly related to the expansion of manufacturing capacity. The Group's investment in fixed assets is now mostly related to further increases in capacity rather than the underlying capability.

FINANCIAL REVIEW

FIXED ASSETS (CONTINUED)

Depreciation for the first half of 2007 was £0.3 million (2006: £0.3 million). Accumulated depreciation at 30 June 2007 stands at 80% of the gross cost of the assets.

WORKING CAPITAL

Net current assets, excluding cash, loans and short term investments (working capital), increased from £3.1 million at 31 December 2006 to £3.4 million at 30 June 2006. Stocks increased by £0.2 million, trade debtors increased by £0.3 million and trade creditors decreased by £0.1 million. These increases in working capital were partially offset by the reduction in the receivable debt relating to the R&D tax credit £0.3 million, following payments received in the first quarter from HM Revenues & Customs.

The working capital increases were due to increased trading activity in the first half of 2007 when compared to the second half of 2006.

LOANS

The Group reached agreement with its lenders ETV Capital S.A. (Luxembourg) regarding the deferment of the commencement of principal repayments on the 2005 equipment loan and

the 2006 convertible loan by three months and six months, respectively. This will reduce the Group's cash outflow in the second half of 2007 by approximately £0.5 million.

EQUITY FUNDRAISING

In February 2007, the Group raised £10.5 million gross, £10.1 million net after transaction costs of £0.4 million, via the placing of 5.25 million shares at a price of 200p. The transaction costs were direct costs of the share issue and have been set off against the share premium account. The cash balance at 30 June 2007 was £6.8 million, exceeding post-fundraising expectations by £1.4 million.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

As disclosed in note 1, the next annual financial statements of the Group will be prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the EU. Accordingly, the interim report has been prepared in accordance with IFRS and the accounting policies are consistent with those that will be used in the annual financial statements.

FINANCING

As a result of the issues set out in the trading statement on 21 August 2007, and as explained in the Chairman's statement, the Group requires further funding to meet its working capital requirements prior to the end of this financial year.

STEVE BERG
CHIEF FINANCIAL OFFICER
28 SEPTEMBER 2007

UNAUDITED CONSOLIDATED INCOME STATEMENT

FOR THE SIX MONTHS TO 30 JUNE 2007

CONTINUING OPERATIONS

	Notes	6 months to 30 June 2007 (unaudited) £000	6 months to 30 June 2006 (unaudited) £000	12 months to 31 December 2006 (audited) £000
Revenue	2	7,159	2,985	7,065
Cost of sales		(7,907)	(4,034)	(10,115)
Gross loss		(748)	(1,049)	(3,050)
Other operating income		36	53	147
Administrative expenses		(4,757)	(3,747)	(8,394)
Operating loss		(5,469)	(4,743)	(11,297)
Investment revenues		138	98	140
Finance costs		(192)	(97)	(183)
Loss before tax		(5,523)	(4,742)	(11,340)
Tax credit		200	160	355
Loss for the period from continuing operations		(5,323)	(4,582)	(10,985)
Basic and diluted loss per share		(21.6p)	(25.9p)	(58.1p)

UNAUDITED CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

FOR THE SIX MONTHS TO 30 JUNE 2007

All amounts are derived from continuing activities.

	6 months to 30 June 2007 (unaudited) £000	6 months to 30 June 2006 (unaudited) £000	12 months to 31 December 2006 (audited) £000
Foreign exchange differences on retranslation of net assets of subsidiary undertakings	(19)	(216)	(126)
Loss for the period	(5,323)	(4,582)	(10,985)
Total recognised income and expense for the period	(5,342)	(4,798)	(11,111)

UNAUDITED CONSOLIDATED BALANCE SHEET

AT 30 JUNE 2007

	Notes	30 June 2007 (unaudited) £000	30 June 2006 (unaudited) £000	31 December 2006 (audited) £000
Non-current assets				
Property, plant and equipment		2,702	2,476	2,596
Current assets				
Inventories		2,186	1,818	1,991
Trade and other receivables		3,823	3,624	3,532
Cash and cash equivalents		6,819	1,791	2,113
R&D tax assets		552	644	839
		13,380	7,877	8,475
Total assets		16,082	10,353	11,071
Current liabilities				
Trade and other payables		(3,180)	(2,494)	(3,277)
Loans and convertible loan notes		(1,248)	(670)	(894)
		(4,428)	(3,164)	(4,171)
Net current assets		8,952	4,713	4,304
Non-current liabilities				
Loans and convertible loan notes		(1,596)	(692)	(1,950)
Long-term provisions		(213)	(222)	(104)
Total liabilities		(6,237)	(4,078)	(6,225)
Net assets		9,845	6,275	4,846
Equity				
Share capital	3	656	442	522
Share premium account	3	25,270	10,605	15,330
Merger reserve	3	50,389	50,389	50,389
Equity reserve	3	429	83	162
Translation reserve	3	(145)	(216)	(126)
Retained earnings	3	(66,754)	(55,028)	(61,431)
Total equity		9,845	6,275	4,846

UNAUDITED CONSOLIDATED CASH FLOW STATEMENT

FOR THE SIX MONTHS TO 30 JUNE 2007

	Notes	6 months to 30 June 2007 (unaudited) £000	6 months to 30 June 2006 (unaudited) £000	12 months to 31 December 2006 (audited) £000
Net cash outflow from operating activities	4	(5,147)	(5,801)	(11,359)
Cash flows from investing activities				
Interest received		138	98	140
Purchases of property, plant and equipment		(403)	(326)	(747)
Net cash used in investing activities		(265)	(228)	(607)
Cash flows from financing activities				
Proceeds on issue of share capital		10,507	—	5,014
Payments of expenses on issue of equity shares		(433)	—	(209)
New borrowings		—	—	1,750
Repayment of borrowings		—	(306)	(573)
Net cash from/(used in) financing activities		10,074	(306)	5,982
Net increase/(decrease) in cash and cash equivalents		4,662	(6,335)	(5,984)
Cash and cash equivalents at start of period		2,113	8,126	8,126
Effect of foreign exchange rate changes		44	—	(29)
Cash and cash equivalents at end of period		6,819	1,791	2,113

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS TO 30 JUNE 2007

1. ACCOUNTING POLICIES

BASIS OF PREPARATION

Prior to 2007, the Group prepared its annual financial statements in accordance with UK Generally Accepted Accounting Principles (UK GAAP). For the interim accounts to 30 June 2007 and continuing, the Group is required to prepare its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) adopted for use in European Union.

The Group is required to apply all relevant standards and accounting policies that are in force at the first reporting date. However as some of these policies are still subject to change, the directors have made assumptions about the accounting policies expected to be applied when the first annual IFRS financial statements are prepared for the year ended 31 December 2007. These accounting policies are therefore subject to changes due to interpretation, new standards and guidance.

The full set of accounting policies under IFRS is detailed below. An explanation of how the transition to IFRS has affected the reported financial results is provided in notes 5 and 6. The accounting policies have been consistently applied to all periods presented.

The financial information contained in this interim statement does not amount to statutory financial statements within the meaning of section 240 Companies Act 1985. The financial information contained in this report is unaudited but has been reviewed by Deloitte & Touche LLP and their report is attached. The financial statements for the year ended 31 December 2006, from which information has been extracted were prepared under UK GAAP and have been delivered to the Registrar of Companies. The report of the auditors was unqualified and did not contain a statement under section 237 (2) or (3) Companies Act 1985.

BASIS OF PREPARATION – GOING CONCERN

As set out in the chairman and CFO statements of the Group, as a result of the matters discussed in the trading statement of 21 August 2007, the Group requires additional funding in order to meet its working capital requirements prior to the end of this financial year. The directors are currently in discussion with a number of parties to raise additional finance and remain confident that the necessary funds will be raised to meet these working capital requirements. On this basis the directors continue to adopt the going concern basis in preparing these interim statements, and accordingly these statements do not contain any adjustments that would result if sufficient additional funding were not to be received on a timely basis.

Given the above, there is a material uncertainty which may cast significant doubt as to the Group's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. Should the level of funding required by the Group to meet its working capital requirements be raised subsequent to this interim statement then this material uncertainty will be removed.

BASIS OF ACCOUNTING

The interim statement has been prepared in accordance with IFRS for the first time. The disclosures required by IFRS 1 concerning the transition from previously reported UK GAAP to IFRS are given in notes 5 and 6.

Because we have adopted all the latest UK GAAP standards in prior period accounts, there are minimum changes in the IFRS conversion process.

BASIS OF CONSOLIDATION

The Group financial statements consolidate the financial statements of SPI Lasers plc and all its subsidiary undertakings drawn up to 31 December each year. All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS TO 30 JUNE 2007

1. ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes.

Revenue from goods is recognised when title passes, or the right to consideration in exchange for performance, has been completed.

Revenue is recognised on long-term contracts by including in the income account revenue as calculated by reference to the value of work performed to date as a proportion of the total contract value. On cost plus contracts, this is by reference to the costs incurred to date, whereas on fixed price contracts, this is by reference to achieved contractual milestones.

Interest income is accrued on a time basis.

PROFIT TAKING ON LONG-TERM CONTRACTS

Profit is recognised on long-term contracts if the final outcome can be assessed with reasonable certainty and by including in the income account both revenue and related costs as contract activity progresses. If the assessment of the final outcome is that there will be an overall loss on the contract, then the said loss is provided for immediately.

PROPERTY, PLANT AND EQUIPMENT

Tangible fixed assets are included at their original historic cost less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Assets in the course of construction for production, administrative purposes, or for purposes not yet determined, are carried at cost less any recognised impairment loss. Depreciation on these assets commences when the assets are ready for their intended use.

Depreciation is charged so as to write off the cost of assets other than assets under construction, down to their residual value, over their estimated useful lives, using the straight-line method, on the following basis:

- Leasehold improvements – the shorter of ten years or remainder of lease
- Fixtures and equipment – five years
- Computer equipment – three years

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Any impairment in the value is charged to income. The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

INVESTMENTS

Investments in subsidiary undertakings are stated in the parent Company's accounts at cost, less provisions for any impairment.

1. ACCOUNTING POLICIES (CONTINUED)

INVENTORIES

Inventories are stated at the lower of cost and net realisable value with due allowance for any obsolete or slow moving items. Cost includes materials and an attributable proportion of manufacturing overheads that have been incurred to bring inventories to their present location and condition. Net realisable value is based on estimated selling price less any further costs expected to be incurred to completion and disposal. Inventories held for demonstration purposes are held at original cost and amortised over a period of twelve months.

PROVISIONS FOR LIABILITIES AND CHARGES

A provision is recognised when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation.

PROVISION FOR PRODUCT WARRANTY

This relates to estimated warranty costs which are expected to be incurred under the Group's terms and conditions of sale. The costs are expected to arise between one and two years of the balance sheet date.

TAXATION

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

FINANCIAL LIABILITIES AND EQUITY

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

CONVERTIBLE LOAN NOTES

Convertible loan notes are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue the fair value of the liability component is estimated using the prevailing market interest rate for non-convertible debt. The difference between the proceeds of issue of the convertible loan and the fair value assigned to the liability element, representing the embedded option to convert the liability into equity of the Group, is included in equity.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS TO 30 JUNE 2007

1. ACCOUNTING POLICIES (CONTINUED)

EQUITY INSTRUMENTS

Equity instruments issued by the Group are recorded as the proceeds received, net of direct issue costs.

SHARE-BASED PAYMENTS

The Group has applied the requirements of IFRS 2 Share-based Payment. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that had not vested as of 1 January 2006. The Group issues equity-settled share-based payments to employees. 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 the Black Scholes model. 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.

FOREIGN CURRENCIES

The individual financial statements of each Group Company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group Company are expressed in pound Sterling, which is the functional currency of the Group, and the presentation currency for the consolidated financial statements.

FOREIGN CURRENCIES: COMPANY

Transactions in foreign currencies are recorded at the rate ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period.

FOREIGN CURRENCIES: GROUP

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates ruling at the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve.

RESEARCH AND DEVELOPMENT

Research expenditure is charged to income in the year in which it is incurred.

Expenditure incurred in the development of products, and their related intellectual property rights, is capitalised as an intangible asset only when:

- ➔ technical feasibility has been demonstrated;
- ➔ adequate technical, financial and other resources exist to complete the development, which the Group intends to complete and use;
- ➔ future economic benefits expected to arise are deemed probable; and
- ➔ the costs can be reliably measured.

1. ACCOUNTING POLICIES (CONTINUED)

RESEARCH AND DEVELOPMENT (CONTINUED)

Development costs not meeting these criteria are expensed in the income statement as incurred. Capitalised development costs are amortised on a straight-line basis over their useful economic lives once the related products are available to use.

No such costs have been capitalised because of the short time between technical feasibility and saleable products.

LEASING

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

RETIREMENT BENEFIT COSTS

The Group makes defined contributions to employee personal pension plans. The pension cost charged as an expense represents the contributions payable to the pension plans in respect of the accounting year.

LONG-TERM CONTRACTS

Amounts recoverable on long-term contracts, which are included in trade and other receivables, are stated at the net sales value of the work done less amounts received as progress payments on account. Excess progress payments are included in trade and other payables as payments on account.

LOSS PER SHARE

IAS 33 requires presentation of diluted EPS when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. For a loss making company with outstanding share options, net loss would only be increased by the exercise of out-of-the-money options. Since it seems inappropriate to assume that the option holders would act irrationally, no adjustment is to be made to diluted EPS for out-of-the-money share options.

2. REVENUE AND GEOGRAPHICAL ANALYSIS

In the opinion of the directors, the Group has only one class of business and revenue and losses were generated predominantly in the United Kingdom.

An analysis of the Group's revenue within this class of business is as follows:

	6 months to 30 June 2007 (unaudited) £000	6 months to 30 June 2006 (unaudited) £000	12 months to 31 December 2006 (audited) £000
Revenue:			
Products	6,377	1,807	4,707
Contract development	782	1,178	2,358
	7,159	2,985	7,065

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS TO 30 JUNE 2007

2. REVENUE AND GEOGRAPHICAL ANALYSIS (CONTINUED)

The following table provides an analysis of the Group's sales by geographical market.

	6 months to 30 June 2007 (unaudited) £000	6 months to 30 June 2006 (unaudited) £000	12 months to 31 December 2006 (audited) £000
Asia	3,442	534	1,603
North America	1,543	908	2,574
Rest of Europe	1,457	866	1,275
United Kingdom	717	677	1,613
	7,159	2,985	7,065

3. CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital £000	Share premium £000	Merger reserve £000	Equity reserve £000	Translation reserve £000	Profit and loss £000	Total £000
At 1 January 2007	522	15,330	50,389	162	(126)	(61,431)	4,846
Arising on share issues	134	10,373	—	—	—	—	10,507
Share issue costs	—	(433)	—	—	—	—	(433)
IFRS 2 charge	—	—	—	267	—	—	267
Retained loss for the period	—	—	—	—	—	(5,323)	(5,323)
Exchange differences on retranslation of net assets of subsidiary undertakings	—	—	—	—	(19)	—	(19)
At 30 June 2007	656	25,270	50,389	429	(145)	(66,754)	9,845

4. NOTES TO THE CASH FLOW STATEMENT

A) RECONCILIATION OF OPERATING LOSS TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	6 months to 30 June 2007 (unaudited) £000	6 months to 30 June 2006 (unaudited) £000	12 months to 31 December 2006 (audited) £000
Operating loss	(5,469)	(4,743)	(11,297)
Adjustments for:			
Depreciation on property, plant and equipment	297	274	575
Increase in receivables	(291)	(1,421)	(1,330)
(Increase)/decrease in inventories	(195)	266	93
(Decrease)/increase in payables	(97)	(168)	831
Increase/(decrease) in provisions	109	57	(61)
Exchange difference	(63)	—	(97)
Share based payment expense	267	31	110
R&D tax credit received	487	—	—
Interest paid	(192)	(97)	(183)
Net cash from operating activities	(5,147)	(5,801)	(11,359)

B) ANALYSIS OF NET DEBT

	At 1 January 2007 £000	Cash flow £000	Non-cash movements £000	Exchange difference £'000	At 30 June 2007 £000
Cash at bank and in hand	2,113	4,662	—	44	6,819
Loans – short term	(894)	—	354	—	(1,248)
Loans – long term	(1,950)	—	(354)	—	(1,596)
	(731)	4,662	—	44	3,975

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS TO 30 JUNE 2007

5. IFRS 1 – FIRST TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Group has applied IFRS 1 First Time Adoption of International Financial Reporting Standards as a starting point for reporting under IFRS. The Group's date of transition to IFRS is 1 January 2006 and comparative information has been restated to reflect the Group's adoption of IFRS except where otherwise required or permitted by IFRS 1.

IFRS 1 requires an entity to comply with each IFRS and IAS effective at the reporting date for its first financial statements prepared under IFRS. As a general rule IFRS 1 requires such standards to be applied retrospectively to determine the IFRS opening balance sheet at the date of transition, 1 January 2006. IFRS 1 provides a number of optional exemptions to this general principle. The ones applicable to the Group are set out below, together with a description of the exemption adopted by the Group.

In accordance with IFRS 1 First-time Adoption of International Financial Reporting Standards the Group is required to present reconciliations of its equity at the date of transition 1 January 2006, at the previous year's interim date 30 June 2006 and at the date of the most recent annual financial statements (31 December 2006), together with its profit and loss for the same periods.

The Group has elected to take advantage of the exemption available to reset the cumulative exchange differences on net investment in foreign operations to zero at the date of transition. Accordingly the Group has not separately disclosed the amount of cumulative translation differences for its overseas operation included within retained earnings at 1 January 2006.

The Group has applied the requirements of IFRS 2 Share-based Payments. In accordance with IFRS 1, IFRS 2 has been applied to all grants of equity instruments after 7 November that has not vested as of 1 January 2006.

6. DETAILS ON IFRS CHANGES IMPACTING PUBLISHED RESULTS

RECONCILIATION OF LOSS FOR 2006

There was no effect on the income statement for the period ended 30 June 2006 and year ended 31 December 2006 following the transition to IFRS.

RECONCILIATION OF IFRS ADOPTION ON CASH FLOW STATEMENT

There was no effect on the cash flow statement for the period ended 30 June 2006 and the year ended 31 December 2006 following the transition to IFRS.

RECONCILIATION OF EQUITY

The transition to IFRS has no effect on net assets. It only has an impact on equity classification. No reconciliation of equity is required at 1 January 2006 as the option under IFRS to reset the cumulative translation reserve to zero at that date has been taken. The reconciliations of equity at 31 December 2006 (date of last UK GAAP financial statements) have been included below to enable a comparison of the 2007 interim figures with the corresponding period of the previous financial year.

6. DETAILS ON IFRS CHANGES IMPACTING PUBLISHED RESULTS (CONTINUED)

RECONCILIATION OF EQUITY AT 31 DECEMBER 2006 (DATE OF LAST UK GAAP FINANCIAL STATEMENTS)

	UK GAAP £000	Unaudited effect of transition to IFRS £000	IFRS £000
Equity			
Share capital	522	—	522
Share premium account	15,330	—	15,389
Merger reserve	50,389	—	50,389
Equity reserve	162	—	162
Translation reserve	—	(126)	(126)
Retained earnings	(61,557)	126	(61,431)
	4,846	—	4,846

RECONCILIATION OF EQUITY AT 30 JUNE 2006 (SIX MONTH COMPARATIVE FIGURES)

	UK GAAP £000	Unaudited effect of transition to IFRS £000	IFRS £000
Equity			
Share capital	442	—	442
Share premium account	10,605	—	10,605
Merger reserve	50,389	—	50,389
Equity reserve	83	—	83
Translation reserve	—	(216)	(216)
Retained earnings	(55,244)	216	(55,028)
	4,846	—	4,846

INDEPENDENT REVIEW REPORT

TO THE MEMBERS OF SPI LASERS PLC

INTRODUCTION

We have been instructed by the Company to review the financial information for the six months ended 30 June 2007 which comprises the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash flow statement and related notes 1 to 6. 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 Bulletin 1999/4 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review 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 formed.

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 also responsible for ensuring that the accounting policies and presentation applied to the interim figures are consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

REVIEW WORK PERFORMED

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of Group 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 excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with International Standards on Auditing (UK and Ireland) 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 June 2007.

EMPHASIS OF MATTER – GOING CONCERN

Without qualifying our review conclusion, we draw attention to the disclosures made in note 1 of the interim report concerning the Group's ability to continue as a going concern. The Group incurred a net loss of £5.3 million during the six months ended 30 June 2007 and a net cash outflow from operating activities of £5.1 million. This, along with other matters as set forth in note 1, indicate the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. The interim report does not include the adjustments that would result if the Group was unable to continue as a going concern.

DELOITTE & TOUCHE LLP

CHARTERED ACCOUNTANTS, SOUTHAMPTON, UK, 28 SEPTEMBER 2007

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D Cheesman
D Holloway (appointed 1 October 2007)
G Meek
D Parker
D Payne
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