



Interim Financial Statements 2006

Index to the interim financial statements

Chairman's Statement	2
Interim group income statement	5
Interim group balance sheet	6
Interim statement of changes in group's shareholders' equity	7
Interim group cash flow statement.....	8
Notes to the interim financial statements.....	9
1 Accounting policies and basis of preparation	9
2 Segment Information	10
3 Earnings per share	11
4 Dividends per share.....	11
5 Acquisition of Peladon Software Group.....	12

Chairman's Statement

Results

I am pleased to report that the results for the first half of 2006 are better than for a similar period last year with an increase in turnover and a return to profitability. Strong international sales as well as election projects in the UK increased turnover by 42 per cent. Profit grew compared with last year but has been suppressed by the impact of the acquisition of Peladon and ongoing investment in the development of the e-Marker® product during the period.

The acquisition of Peladon on 31 January 2006 provided DRS with a complementary knowledge base and portfolio of document processing products that are continuing to give DRS a keen competitive edge in existing and new markets. Sales in the American market are tracking the original business plan and sales of DocXP through the DRS channel are progressing well.

Financial Summary

Turnover for the first half of 2006 was £8,985,000 compared with a figure of £6,325,000 for the first half of 2005. Profit before tax for the six months ending 30 June 2006 was £336,000 compared with a loss of £277,000 for the 28 weeks ending 15 July 2005.

At the start of the year the company changed to accounting monthly rather than its previous system of 13 - four week periods which has reduced the 2006 half year by two weeks when compared with 2005. This has resulted in approximately £1,400,000 of revenue falling in the second half of the year which previously would have been reported in the first half. As a result, none of the AQA summer series examination marking contribution will be recognised until the second half of the year.

The cash position at 30 June of £384,000 was lower than the £2,284,000 at the full year due to the increased level of business activity resulting in a larger investment in working capital and an outflow of cash in the first half of the year. However, £2,900,000 of debt outstanding with the European Commission for the Nigerian census project was received in August 2006.

Dividend

In recognition of the growth of the business and the half year results the Board is pleased to recommend an interim dividend payment of 0.25p per share (2005: nil), payable on 3 November 2006 to those shareholders on the register of the Company on 29 September 2006.

Trading Highlights

The year started with the completion of the largest single contract for printing services the company has been awarded. The project to print forms for the Nigerian Census started in 2005 and was funded by the European Union. In total more than 50 million forms were designed and produced and this accounted for 550 tonnes of paper which we shipped to locations across Nigeria.

Our election business is usually centred around the first week of May, when most UK elections are held, however this year has been different. As reported in the last annual report we were pleased to have been awarded a contract by the Scottish Executive for the potential use of e-Counting technology in the first STV (Single Transferable Vote) elections to be held in Scotland in 2007. The initial part of the contract, awarded with our partner Electoral Reform Services Limited, was for trials of our e-Counting technology with all 32 of the Scottish Local Authorities. These trials, held in February in three locations around Scotland, were completed successfully and led to the acceptance phase of the contract. I am pleased to announce that the acceptance tests were also successful and subsequently Scottish Ministers and the Secretary of State for Scotland have given the go ahead for the use of DRS e-Counting technology in the elections next year.

As well as the above we were also pleased to have been selected to take part in two election trials for the DCA (Department for Constitutional Affairs). These were part of the local elections in May and were run by two London authorities, Westminster and Lewisham, who trialled new concepts such as early voting. We also had an opportunity to demonstrate the benefits of e-Counting in June when DRS technology was used by the Loch Lomond and Trossachs National Park to elect five members to its National Parks Authority.

Our largest project this year is the use of e-Marker[®] for examinations and assessment. The volumes of examination scripts processed by e-Marker[®] have been increasing each year and the total will exceed 4 million for 2006. We will continue to make considerable investment in the product and services, the volume of business is now substantial and is responsible for a significant proportion of the DRS revenue. The biggest customer for e-Marker[®] remains AQA (Assessment and Qualifications Alliance) and during the summer series of GCSE examinations we will have assisted in the marking of nearly 3.6 million scripts and e-Marker[®] will have been used by 6,400 examiners in their homes. Many different variants of the technology have been used to best suit the types of assessment, from simple mark capturing on-screen, to complete marking of answer scripts from on-screen images. A new module was also introduced this year called CMM (Computer Marking from Multimedia) which has widened the scope of e-Marker[®] to handle more examination subjects. Overall our electronic marking suite was used by AQA to capture a total of 65 million individual marks awarded to students answers.

We continue to supply e-Marker[®] services to a number of other awarding bodies around the UK as well as organisations offering professional qualifications. I am also pleased to report that e-Marker[®] is being used in Australia and we have completed our first project in France. La Maison des Examens have used a combination of Peladon's DocXP product to scan examination scripts and DRS e-Marker[®] to mark the answers from the scanned images. The successful outcome was covered widely by French media and the press.

Since acquiring Peladon Software at the beginning of the year both San Diego (USA) and Andover (UK) companies have progressed well with product development and sales of the DocXP suite of software. A number of significant sales have been made in the first half of the year and the company's expertise in the market of financial document processing is proving to be particularly successful. A key US customer, Sungard, who supply software to financial institutions has started to place orders for DocXP and is opening up a strategic market.

Sales of our top range image scanner, the PhotoScribe[®] PS900, have been higher in the first half of the year than expected. Customers in Africa and the Far East have bought PS900s recognising its ability to handle sophisticated real-time data processing capabilities. We are optimistic that this trend will continue in other territories.

Our People

The expansion of our e-Marker[®] work combined with major projects such as the Scottish Elections has maintained pressure on recruitment of both permanent and temporary staff. In particular the adoption of formal project management techniques for much of DRS' business has led to a strong demand for qualified project managers and assistants. This emphasis on project management is however leading to better use of resources and the ability to cope with the large projects that are becoming part of DRS' normal life.

It is the expertise and professionalism of the staff at DRS that continues to keep the company at the forefront of its markets. Their performance in the first half of 2006 enforces this view and bodes well for the future.

Board Changes

Our Senior Independent non-Executive Director, Nigel Turnbull, has decided to retire as a director with effect from 30 September 2006, to give himself more time to concentrate on his other activities. Nigel has been with DRS for five years and has been exceptionally helpful to both his fellow NEDs and the executive team during that time. His depth of knowledge and thought provoking guidance has been invaluable. The Board wishes to thank Nigel for his tireless contribution over the years and we know he will still be available for an occasional piece of advice.

Prospects

e-Marker[®] is now well positioned to grow business with existing customers and win new markets. Awarding and assessment bodies in the UK have made increasing use of e-Marker[®] and we expect this growth to continue over the next few years. The use of electronic marking by other countries looks promising and we will continue to pursue these markets. However, further development of the e-Marker[®] products will be necessary to fully capitalise on these prospects.

Work leading up to the Scottish STV elections is gathering pace and a final volume test of the technology will be conducted for the Scottish Executive in October. The production of more than 300 of our PhotoScribe[®] scanners for the project has started and we have commissioned a specialist production facility in Milton Keynes for the purpose. The scale of the project will also be finalised in October when up to 32 Local Authorities contract to use e-Counting. Assuming most, if not all, of the authorities proceed with the project, it will be larger than the GLA and Mayor elections of 2004.

We have been negotiating for some time with Diebold Election Systems in the US regarding their use of the PhotoScribe[®] scanner for elections in America. Diebold is one of the largest suppliers of election equipment and services in the United States. I'm delighted to report that a contract has been signed giving Diebold exclusive rights to sell PhotoScribe[®] scanners into the American election market and they have placed their first order for 51 machines that will be delivered before the end of the year. This is the largest single order for PS900s that we have ever received.

We continue to supply scanners and forms to UK schools for both attendance monitoring and pupil assessment. This market is however coming under increasing pressure from other technologies in the area of attendance monitoring. The decreasing cost of alternative technology and the requirement by government for schools to reduce truancy is changing the profile of this market. We therefore intend to launch new products based on different technologies into the schools market. Our existing strong channels into schools and their local authorities should give us a significant competitive edge.

We are very pleased with the way Peladon has performed in the first half of the year and it looks set to meet its business plan. Two new product variants of its DocXP product have been launched at trade shows this year and were very positively received by both customers and the press. These products greatly enhance DocXP's ability to process semi-structured forms and documents. This type of processing enables documents which have previously needed to be entered manually to be handled automatically. The technology establishes Peladon as one of the leading companies in the world for this type of work.

Outlook

The first six months have produced an excellent growth in turnover and an increase in profit despite investment in Peladon and continued investment in e-Marker[®]. With the movement of the reporting date to 30 June, the benefits of the AQA summer series examination marking will not be realised until the second half year. We therefore expect the e-Marker[®] work to make a positive contribution in the second half of 2006.

Major work is required in the second half of the year to meet the increasing volume requirements for e-Marker[®] and to prepare for the Scottish STV Elections in 2007. However this is building on knowledge and experience within DRS which we already have a track record of providing.

An encouraging sign for our future is the level of interest in our products from around the world. DRS has raised its profile in international markets for our main products of PhotoScribe[®] scanners, e-Counting and e-Marker[®]. The acquisition of Peladon has broadened our profile and complements our existing products. This year has seen strategic sales into new markets which should further enhance our reputation as a world leader.

DRS Data & Research Services plc

UNAUDITED RESULTS

Interim group income statement

	6 months ended 30 June 2006 £000	28 weeks ended 15 July 2005 £000	Year ended 31 December 2005 £000
Revenue	8,985	6,325	12,452
Cost of sales	(5,392)	(4,163)	(7,835)
Gross profit	3,593	2,162	4,617
Other operating income	11	93	146
Selling and marketing costs	(740)	(720)	(1,266)
Administrative expenses	(2,480)	(1,797)	(3,420)
Finance costs	(48)	(15)	(60)
Profit/(Loss) before income tax	336	(277)	17
Tax (charge)/credit	(128)	58	(24)
Profit/(Loss) for the period	208	(219)	(7)

Earnings/(Loss) per share for profit attributable to the equity holders of the Company during the year (expressed in pence per share)

- basic	3	0.65p	(0.68p)	(0.02p)
- diluted	3	0.63p	(0.68p)	(0.02p)

Dividend proposed per share	0.25p	-	-
Total dividends proposed	£80,000	-	-

Interim group balance sheet

	At 30 June 2006 £000	At 15 July 2005 £000	At 31 December 2005 £000
ASSETS			
Non-current assets			
Property, plant and equipment	4,376	4,364	4,103
Intangible assets	4,087	608	788
Deferred income tax assets	132	2	20
	<u>8,595</u>	<u>4,974</u>	<u>4,911</u>
Current assets			
Inventories	1,095	1,558	1,517
Trade and other receivables	7,913	2,904	3,133
Other financial assets at fair value through profit or loss	-	1,665	1,063
Cash and cash equivalents	384	1,175	2,284
	<u>9,392</u>	<u>7,302</u>	<u>7,997</u>
Total assets	<u>17,987</u>	<u>12,276</u>	<u>12,908</u>
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	1,731	1,731	1,731
Share premium account	5,377	5,377	5,377
Capital redemption reserve	115	115	115
Treasury shares	(1,166)	(1,166)	(1,166)
Own shares reserve	(113)	(122)	(120)
Profit and loss account	2,631	2,177	2,411
Total equity	<u>8,575</u>	<u>8,112</u>	<u>8,348</u>
LIABILITIES			
Non-current liabilities			
Borrowings	2,250	1,000	-
Deferred consideration	347	-	-
Deferred income tax liabilities	376	-	30
	<u>2,973</u>	<u>1,000</u>	<u>30</u>
Current liabilities			
Trade and other payables	6,155	3,116	3,477
Current income tax liabilities	284	48	53
Borrowings	-	-	1,000
	<u>6,439</u>	<u>3,164</u>	<u>4,530</u>
Total liabilities	<u>9,412</u>	<u>4,164</u>	<u>4,560</u>
Total equity and liabilities	<u>17,987</u>	<u>12,276</u>	<u>12,908</u>

Interim statement of changes in group's shareholders' equity

	Share Capital £000	Share Premium Account £000	Capital Redemption Reserve £000	Treasury Shares £000	Own Shares Reserve £000	Profit and Loss Account £000	Total £000
At 1 January 2005	1,731	5,377	115	(1,166)	(122)	2,692	8,627
Loss for the Period	-	-	-	-	-	(219)	(219)
Employee Share Based Compensation	-	-	-	-	-	25	25
Dividend	-	-	-	-	-	(321)	(321)
At 15 July 2005	1,731	5,377	115	(1,166)	(122)	2,177	8,112
Profit for the Period	-	-	-	-	-	212	212
Employee Share Based Compensation	-	-	-	-	-	22	22
Deferred tax on items relating to equity	-	-	-	-	-	2	2
Dividend	-	-	-	-	-	-	-
Own shares vesting	-	-	-	-	2	(2)	-
At 31 December 2005	1,731	5,377	115	(1,166)	(120)	2,411	8,348
Profit for the Period	-	-	-	-	-	208	208
Employee Share Based Compensation	-	-	-	-	-	16	16
Deferred tax on items relating to equity	-	-	-	-	-	3	3
Dividend	-	-	-	-	-	-	-
Own shares vesting	-	-	-	-	7	(7)	-
At 30 June 2006	1,731	5,377	115	(1,166)	(113)	2,631	8,575

Interim group cash flow statement

	6 months 30 June 2006 £000	28 weeks ended 15 July 2005 £000	Year ended 31 December 2005 £000
Cash flows from operating activities			
Cash generated from operations	(765)	(752)	189
Interest paid	(66)	(31)	(57)
Income tax paid	-	-	(62)
Net cash used in operating activities	<u>(831)</u>	<u>(783)</u>	<u>70</u>
Cash flows from investing activities			
Purchases of property, plant and equipment (PPE)	(425)	(429)	(496)
Proceeds from sale of PPE	11	15	15
Purchase of intangible assets	(456)	(647)	(960)
Peladon acquisition cost	(2,483)	-	-
Purchases of available-for-sale financial assets	-	(21)	(1,032)
Proceeds from sale of financial assets at fair value through profit or loss	1,063	1,781	3,392
Interest received	45	102	138
Net cash (used in)/generated from investing activities	<u>(2,245)</u>	<u>801</u>	<u>1,057</u>
Cash flows from financing activities			
Purchase of treasury shares	-	-	-
Repayment of Subsidiary directors loans	(73)	-	-
Re-mortgage of Linford Wood office	1,250	-	-
Dividends paid to Company's shareholders	-	(321)	(321)
Net cash generated/(used in) from financial activities	<u>1,177</u>	<u>(321)</u>	<u>(321)</u>
Net decrease in cash and cash equivalents	(1,899)	(303)	806
Cash and cash equivalents at beginning of period	<u>2,284</u>	<u>1,478</u>	<u>1,478</u>
Cash and cash equivalents at end of period	<u>385</u>	<u>1,175</u>	<u>2,284</u>

Notes to the interim financial statements

1 Accounting policies and basis of preparation

The financial information comprises the unaudited results for the six months to 30 June 2006 and 28 weeks to 15 July 2005, together with the audited results for the year ended 31 December 2005. The figures and financial information for the year to 31 December 2005 do not constitute the statutory financial statements for that year. Those financial statements have been delivered to the Registrar and included the auditors' report which was unqualified and did not contain a statement either under section 237(2) of the Companies Act 1985, or section 237(3).

DRS has adopted International Financial Reporting Standards (IFRS) with effect from 1 January 2005. These unaudited Group interim results have been prepared on a basis consistent with IFRS accounting policies as set out in the Report and Accounts for the year ended 31 December 2005 with the exception of the approach adopted on the accounting for the acquisition of Peladon Software Inc. being the first group acquisition. Information provided is in accordance with IAS34 interim reporting requirements.

Basis of Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to profit and loss in the period of acquisition.

The results of subsidiaries acquired during the year are included in the consolidated income statement from the effective date of acquisition.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

Notes to the interim financial statements (continued)

2 Segment Information

The principal activities of the Company continue to be the provision of data capture services, the manufacture, sale and support of optical and image scanning equipment, design and printing of documentation used for data capture and associated software and bureau services. Approximately half the Company's revenue relates to products and services, and the other half relates to providing tailored data capture solutions. The Company is organised functionally, with each function of the business specialising in its own area of expertise. Project managers look to the functional areas to provide the appropriate tailored mix of products and services to fulfil each specific contract. In turn the functional areas are supported by indirect cost centre departments such as Research and Development, Communication and Information Development and IT Support.

(a) Primary reporting format – business segments

Reflects the principal activities of the Company: Scanning Equipment; Print; and Software and Bureau services.

The segmental results for the six months ended 30 June 2006 are as follows:

	Scanning Equipment £000	Print £000	Software and Services £000	Total £000
Sales	2,098	4,020	2,867	8,985
Apportioned costs	(1,556)	(2,439)	(3,414)	(7,409)
Operating margin	542	1,581	(547)	1,576
Unallocated costs				(1,240)
Profit before tax				336

The segmental results for the 28 weeks ended 15 July 2005 are as follows:

	Scanning Equipment £000	Print £000	Software and Services £000	Total £000
Sales	2,201	1,876	2,248	6,325
Apportioned costs	(1,566)	(1,602)	(2,559)	(5,727)
Operating margin	635	274	(311)	598
Unallocated costs				(875)
Loss before tax				(277)

The segmental results for the year ended 31 December 2005 are as follows:

	Scanning Equipment £000	Print £000	Software and Services £000	Total £000
Sales	3,741	4,499	4,212	12,452
Apportioned costs	(2,632)	(3,704)	(4,452)	(10,788)
Operating margin	1,109	795	(240)	1,664
Unallocated costs				(1,647)
Profit before tax				17

Notes to the interim financial statements (continued)

3 Earnings per share

The calculation of the basic earnings per share is based on the earnings attributable to ordinary shareholders divided by the weighted average number of shares in issue during the year. Shares held in employee share trusts are treated as cancelled for the purposes of this calculation.

The calculation of diluted earnings per share is based on the basic earnings per share, adjusted to allow for the issue of shares and the post tax effect of dividends and/or interest, on the assumed conversion of all dilutive options and other dilutive potential ordinary shares.

Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below:

	June 2006			15 July 2005			December 2005		
	Earnings £	Weighted average number of shares	Per Share	Earnings £	Weighted average number of shares	Per Share	Earnings £	Weighted average number of shares	Per Share
Basic earnings per share									
Earnings attributable to ordinary shareholders	208,000	32,128,628	0.65p	(219,000)	32,111,071	(0.68p)	(7,000)	32,111,400	(0.02p)
Dilutive effect of shares in restricted share scheme		368,578						-	
Dilutive effect of options under unapproved share option scheme		51,842						-	
Dilutive effect of options under the LTIP Scheme		231,454			-			-	
Dilutive earnings per share		32,780,501	0.63p		32,111,071	(0.68p)		32,111,400	(0.02p)

In the period to 15 July 2005 and 31 December 2005 the share options were anti-dilutive due to the loss for the period.

4 Dividends per share

The directors have declared an interim dividend out of the profit for the six months to 30 June 2006, payable on 3 November 2006 to all shareholders on the register at 29 September 2006, at a rate of 0.25p per share. The interim dividend amounts to £80,000. In accordance with IFRS, the interim dividend will be charged in the Group results to the second half year.

No dividends were made for the year ended 31 December 2005.

5 Acquisition of Peladon Software Group

On the 31 January 2006, DRS Data & Research Services plc acquired a 100% interest in the Peladon Group for £2,745,000 plus costs of £71,000 giving a total cost of £2,816,000. £2,398,000 was payable immediately and the balance of £347,000 is estimated to be payable subject to an earn out provision. This provision defines deferred consideration payable as 50% of the Peladon Group's operating profit in the first three years post acquisition up to a maximum of £347,000 and that the annual profit exceeds £250,000.

The Peladon Group comprises two companies, Peladon Software Inc is based in San Diego, California and is the 100% holding company of Peladon Software Limited based in Andover in the UK.

Peladon Software provides automated Document Management Solutions by employing Intelligent / Optical recognition technology (ICR/OCR).

Net liabilities acquired:

	31 January 2006 £000	Fair Value adjustments £000	Fair Value £000
Tangible assets	41	-	41
Bank	9	-	9
Intangible assets	-	1,195	1,195
Current assets	245	-	245
Total assets	295	1,195	1,490
Liabilities	(52)	-	(52)
Bank overdraft	(23)	-	(23)
Deferred tax	-	(359)	(359)
Current liabilities	(353)	-	(353)
Total liabilities	(428)	(359)	(787)
Goodwill			2,113
Total consideration			2,816

The amount paid for goodwill reflects DRS' perceived value of the Peladon Software Group and the synergies that are expected to arise with DRS.

Basis of fair value calculation

The valuation of intangible assets is based on the cashflow forecasted to be generated by the unpatented technology and know how assets over their estimated useful economic lives, discounted at 15%. On this basis the fair value of intangible assets amounts to :

	£000
Unpatented technology	340
Know how	855
Intangibles	1,195

Unpatented technology is amortised over three years and know how over six years.

The Peladon Software Group's post acquisition results for 2006 are:

	5 months to 30 June 2006 £000
Sales	461
Loss before tax	(146)

Had the Peladon Software Group been acquired from the beginning of the period the consolidated revenue and profit before tax for DRS Data & Research Services plc would have been £9,040,000 and £294,000 respectively.