



**Surface Transforms plc**

Annual Report and Accounts

Registered number 3769702

31 May 2004

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## Highlights

- Prestigious contract wins from Dunlop Aerospace and the United States Airforce Research Laboratory and, more recently, with the German automotive brake systems supplier METEK and a development contract with the UK Ministry of Defence
- Turnover increased by 79% to £428,608 (2003: £239,755)
- Operating losses on ordinary activities reduced by 77% to £256,972 (2003: loss £1,129,909)
- Raised £2.7 million after expenses, significantly strengthening the Company's balance sheet
- Expanding team by hiring new managerial and technical staff

### **Chairman's statement**

We have continued to make progress towards our goal, which is the profitable commercial exploitation of our unique carbon fibre reinforced ceramic (CFRC) materials. The most important events during the past year were the signing of key agreements with Dunlop Aerospace, the United States Air Force Research Laboratory (USAF) and the UK Ministry of Defence (UK MoD) and, more recently, with the European automotive brake systems supplier METEK.

A particularly interesting development was the MoD contract announced in May 2004, in which the MoD is investigating the potential of our CFRC materials for use in body armour. This could be a new income stream for Surface Transforms' technology which until now has been predominantly from sales relating to friction applications.

Our new business model adopted around a year ago has delivered successful entries into all our target aerospace, automotive and anti-ballistic materials markets. As revenues are now increasing and costs have been reduced, our operational and financial position has steadily improved. The Company's working capital and balance sheet have also been strengthened by the share placing in April, which raised £2.7 million after expenses and introduced new financial institutions to our shareholder base.

### **Financial review**

The Company's financial results for the year ended 31 May 2004 show a significant improvement on the comparable period last year.

Turnover increased by 79% to £428,608 (2003: £239,755), while operating losses on ordinary activities were lower at £256,972 (2003: loss £1,129,909) and the Company's cash and working capital position has improved markedly. In addition, the reduction in operating losses is a result of improved financial cost control.

Losses after tax were also lower at £129,524 (2003: loss £964,382), reflecting research and development tax credits of £119,685 (2003: £158,850).

On 30 April 2004, the Company announced the Placing of 4,142,859 new Ordinary shares at 70 pence per share. The net proceeds of the placing was £2.7 million of which £2.4 million was received in late May 2004. The remaining £332,500 was received in late July and is included in debtors at 31 May. The Placing has provided the resources to expand our management and technical teams, and to provide working capital to accelerate the expansion of the business.

At 31 May 2004 the Company held cash and deposits of £2,707,839 (2003: £178,175). Surface Transforms continues to have no bank borrowings.

## **Operating activities**

### ***Aircraft brakes***

In November 2003, Surface Transforms signed a major licensing contract with aircraft braking systems supplier Dunlop Aerospace to develop systems for a designated large commercial airliner. This contract is the first application of the Company's CFRCs in the commercial global aircraft industry. The recent sale of Dunlop Aerospace in July 2004 to Meggitt Plc, the British aerospace and defence company, does not alter the terms of the agreement with Surface Transforms.

The work, to complete a material development programme and to design, install and commission a CFRC brake disc production plant at Dunlop's plant in Coventry, is advancing well. The first certification flight is scheduled for 2006. If the CFRC brake receives its certification from the Civil Aviation Authority for the specified airliner, Dunlop will initiate the supply of CFRC brakes manufactured under a previously announced licence agreement with Surface Transforms. This would secure long-term payments for the Company.

### ***Automotive***

Surface Transforms continues to develop applications within the automotive industry. In June 2004, the Company signed a two-year Cooperative Agreement initially worth € 60,000 with leading German automotive brake parts supplier METEK Metallverarbeitung GmbH of Meckenheim. The contract is for the design, development and supply of carbon ceramic brake discs and pads to METEK for use on high-performance and luxury European road cars.

Entry into the road car market has long been one of the Company's stated objectives. Therefore, the METEK contract represents an important commercial landmark. We estimate that when carbon ceramic brake technology is adopted by major car manufacturers who now use steel or cast iron brake pads and discs, it is likely that we can achieve penetration of between one and three percent of a total market valued at € 3.5 billion.

Initial road car testing of Surface Transforms' materials at METEK has shown that CFRCs offer significant advantages over traditional cast iron brake discs with organic pads. METEK's booth at the European Motor Show in Essen, Germany in November 2004 will be the first occasion at which our new disc and brake systems will be on display, and will allow comparison of the performance of our systems with iron and other carbon ceramic brakes.

We have begun a targeted marketing programme addressing the European automobile industry. The marketing programme is to raise awareness of the benefits of our ceramic brake disc technology, which we believe is inherently superior to the ceramic rotor and pad systems currently used on some high performance European road cars.

### ***Aerospace components***

Since January 2004, work on the Roxel (Rocket Motors) programme has accelerated at Roxel's UK and French locations. In the past six months further CFRC components have been despatched to Roxel UK for rocket nozzle applications. It is the first time Roxel France (formerly Celerg, a division of the French Company SNPE) has used CFRC parts for a fuel valve assembly.

Currently Roxel and Surface Transforms are investigating the details of a closer collaboration, not only for the supply of additional components but also for the generation of specific design data to characterise the performance of our material in the hostile environment of the rocket motor.

In September 2003, Surface Transforms signed its first development contract with the United States Air Force Research Laboratory (USAF) for the supply of prototype CFRC materials. Since signing the agreement, the project has progressed well. It is currently on schedule and on budget. This contract was for 12 months. Extension of this contract is dependent on budget constraints at USAF but we have received very encouraging feedback from the extensive testing that has occurred during the first part of the contract.

### **New applications for CRFC technology**

#### ***Ballistics***

In May this year the Company was awarded a contract worth around £40,000, by the UK Ministry of Defence for the development and testing of anti-ballistic materials for use in infantry body armour and possibly as an anti-ballistic "skin" for armoured personnel carriers and weapon platforms.

Preliminary investigations show that our CFRCs offer protection against repeat hit high-power rifle shot, as well as weight saving advantages compared with standard alumina ceramic armour plates. Work is expected to be completed by around March 2005, subject to satisfactory product performance. The directors anticipate that if the performance is acceptable it should lead initially to commercial orders for body armour.

#### **Technology**

Non-executive director Professor David Clark continues to provide guidance to the technology team and he has recently completed an in-house review of the Company's technology and its comparative positioning within the world market. We have also recently commissioned two detailed market and technical research projects in the fields of aircraft brake systems and European automotive brakes and clutches.

In terms of other new developments, two new patent applications for additional products and processes in the area of CFRCs are being prepared in readiness for expected submission by the end of this calendar year.

### **Management**

Following the successful share placing we have strengthened our technical and management teams, and will continue to do so. Dr. Kevin Johnson PhD, MBA (aged 32), an industrial chemist with substantial experience, has joined as Operations Director. His appointment will be followed by the recruitment of three more technical executives in the areas of materials science and application engineering. The first of these appointments has already been made with Geoff Whitfield, a composites and aeronautical engineer, joining later this month. We expect to fill the remaining positions by the end of the year.

The sales team will be strengthened by the appointment of a senior sales executive to assist Julio Faria and Dr. Geoff Gould in developing and growing the business. This appointment will be made after the completion of the market research projects on the aircraft and road car brake markets described above.

Kate Hickman, formerly Operations Manager, has reduced her full-time involvement and is now employed as a consultant for one week per month. Kate has been with Surface Transforms for six years and her contribution to the development of our CFRC technology has been outstanding. We are delighted that she continues to apply her great enthusiasm and talents to the business.

### **Outlook**

This has been a year of strong progress. We now have key contracts in place in our target aerospace and automotive markets, and following the £2.7 million fundraising in April, have the financial strength to deliver our business objectives.

We are happy with the way the Company is structured and financed, leaving us free to focus on completing work on our key contracts, as well as having the resources in place to explore additional commercial opportunities for our unique materials. The agreements that Surface Transforms has currently signed have the potential to bring in significant repeat revenues and it is our priority to ensure the development milestones are met on time and to standard.

The success of the fundraising will allow the Company to achieve these aims. It also provides the capital to accelerate the development of our CFRC technology and invest in management and technical infrastructure which in turn will ensure that the higher levels of business activity are supported.

We are now moving towards the goal set out in our business model to develop Surface Transforms into a company with first class technical, product development and business development capabilities.

There is a high level of confidence within the Company, shared by employees and directors alike. Our recent new contract wins reflect the dedication and integrity of all employees. I would like to thank my board colleagues and talented staff for their hard work and commitment during a year of strong progress.

**Kevin D'Silva**, Chairman

## **Directors' report**

The directors present their annual report and the audited financial statements for the year ended 31 May 2004.

### **Principal activity**

The principal activity of the company during the year was the development and manufacture of carbon fibre reinforced ceramic friction products (CFRC).

### **Business review**

A review of the company's activities during the year is dealt with in the Chairman's statement.

### **Future developments**

The Board aims to continue with its corporate strategy which is to exploit its technologies in carbon fibre reinforced ceramics by:

- establishing contract development opportunities and collaborations with national and multi-national customers in the automotive and defence industries; and
- expanding commercial sales of CFRC products.

### **Research and development**

The majority of the company's staff are employed in research and development activities which are concentrated on the ongoing development of carbon ceramic friction and non-friction materials for new products and applications.

### **Proposed dividend and transfer to reserves**

The loss for the year after taxation amounted to £129,524. The directors do not recommend the payment of a dividend.

### **Policy and practice on payment of creditors**

It is the company's policy that payments to suppliers are made in accordance with the terms and conditions agreed between the company and its suppliers, providing that all trading terms and conditions have been complied with. The company does not follow any code or standard on payment practice.

At the year ended, there were 56 days (*2003: 14 days*) purchases in trade creditors.

### **Political and charitable donations**

The company made no political or charitable donations during the year (*2003: £nil*).

**Directors and directors' interests**

The directors who held office during the year were as follows:

K D'Silva* (Chairman)	PJ Holland*
JJ Faria	DM Whitney (resigned 14 October 2003)
Professor DT Clark*	DE Levis (resigned 29 August 2003)
Dr G Gould	

\* denotes non executive Director.

The directors retiring by rotation are David Clark and Geoff Gould who, being eligible, offer themselves for re-election.

The directors who held office at the end of the financial year had the following interests in the ordinary shares of the company according to the register of directors' interests:

	% of issued share capital	Number of £0.01 ordinary shares	
		Interest at end of year	Interest at start of year
JJ Faria	17.61	2,326,845	2,623,845
Professor DT Clark	7.53	994,661	1,024,661
K D'Silva	1.15	151,486	5,967
PJ Holland	1.29	170,515	10,758
Dr G Gould	0.03	4,350	4,350

According to the register of directors' interests, no rights to subscribe for shares in or debentures of the company were granted to any of the directors or their immediate families, or exercised by them during the financial year, except as disclosed in the report on directors' remuneration on pages 9 to 11.

**Substantial shareholders**

The addition to the directors' interests noted above, the directors are aware of the following who were interested in 3% or more of the company's equity at the end of the year.

	Registered holding	% of issued share
	Number	Capital
BNY (OCS) Nominees Limited	807,143	6.11
Bank of New York Nominees Limited	714,286	5.40
HSBC Global Custody Nominee (UK) Limited	640,380	4.85
JM Finn Nominees Limited	604,002	4.57
Barclayshare Nominees Limited	408,733	3.09

### **Corporate Governance**

Surface Transforms plc is committed to maintaining high standards of corporate governance. The company complies with the Combined Code as modified by the recommendations of the Quoted Companies Alliance to the extent the directors consider appropriate, given the size of the company, its current stage of development and the constitution of the Board.

The Board has appointed an Audit Committee whose primary role is to review the company's interim and annual financial statements before submission to the Board for approval. The Board has also appointed a Remuneration Committee, which is responsible for reviewing executive remuneration and performance. Both the Audit Committee and Remuneration Committee are made up of two non executive directors. The Audit Committee is currently composed of Peter Holland and Kevin D'Silva. Details of the Remuneration Committee are disclosed in the report on directors' remuneration on pages 9 to 11.

### **Auditors**

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the company is proposed at the forthcoming Annual General Meeting.

By order of the board

### **K D'Silva**

Chairman, Surface Transforms plc  
April House, Tarvin Road,  
Frodsham, Cheshire WA6 6XN

### **Report on directors' remuneration**

#### **Policy on executive directors' remuneration**

The Remuneration Committee comprises Kevin D'Silva and Peter Holland.

The Remuneration Committee is responsible for reviewing and determining the company's policy on executive remuneration (including the grant of options under the Share Option Scheme) and ensuring compliance with and implementation by the company, as far as reasonably practicable, the recommendations and guidelines of the Combined Code. Executive remuneration packages are designed to ensure the company's executive directors and senior executives are fairly rewarded for their individual contributions to the company.

#### **Fees for non executive directors**

The fees for non executive directors are determined by the Board. The non executive directors are not involved in the decisions about their own remuneration.

**Directors' remuneration - audited**

Set out below is a summary of the fees and emoluments received by all directors for the year or where applicable, period of office:

	2004 £	2003 £
<i>Executive directors</i>		
JJ Faria	46,359	47,934
Dr G Gould	36,124	33,816
DE Levis	44,795	49,323
<i>Non executive directors</i>		
K D'Silva	12,020	-
PJ Holland	21,030	-
Professor DT Clark	13,366	4,443
DM Whitney	3,055	27,450

No pension contributions were paid on behalf of directors.

**Directors' interests**

Details of any contracts in which a director has a material interest are disclosed in note 21.

None of the directors received any remuneration or benefits under long-term incentive schemes.

**Share options – audited**

The company operates a share incentive scheme. All options are granted at the discretion of the Board. The options granted, date of grant, exercise price and exercise periods under the scheme are set out below. During the year options to the directors and selected employees to purchase ordinary shares were granted at an exercise price of £0.88 and £0.665 each.

None of the directors exercised options during the year. Directors' options outstanding and the options which were granted and expired during the year are as follows:

***Enterprise Management Incentive Scheme***

Director	Date of Grant	Number of Share options granted	Number of Share options expired	Exercise Price	Exercise Period	Expiry Date
JJ Faria	19/12/02	64,286		£0.70	19/12/05-19/12/12	19/12/12
DE Levis	19/12/02	64,286	(64,286)	£0.70	19/12/05-19/12/12	29/08/03
Dr G Gould	19/12/02	64,286	-	£0.70	19/12/05-19/12/12	19/12/12
Dr G Gould	08/12/03	34,091		£0.88	08/12/06-08/12/13	08/12/13
Dr G Gould	08/03/04	20,000		£0.665	08/03/07-08/03/14	08/03/14

The market price of the shares at 31 May 2004 was £0.765 and during the period varied from £0.21 to £0.865. The market price of the shares from the date of share options were granted has varied from £0.12 to £0.865.

By order of the board

**K D'Silva**

Chairman

Surface Transforms plc

### **Statement of directors' responsibilities**

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

KPMG Audit Plc  
St James' Square  
Manchester M2 6DS  
United Kingdom

## **Report of the independent auditors to the members of Surface Transforms plc**

We have audited the financial statements on pages 14 to 30. We have also audited the information in the report on directors' remuneration on pages 9 to 11 that is also described as being audited.

This report is made solely to the company's members, as a body in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' 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 and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The directors are responsible for preparing the directors' report and the report on directors' remuneration. As described on page 11, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and part of the report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read the other information accompanying the financial statements including the unaudited part of the report on directors' remuneration, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

**Basis of audit opinion**

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and part of the report on directors' remuneration to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the report on directors' remuneration to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and part of the directors' report to be audited.

**Opinion**

In our opinion:

- the financial statements give a true and fair view of the state of the company's affairs as at 31 May 2004 and of its loss for the year then ended; and
- the financial statements and the part of the report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc  
*Chartered Accountants*  
*Registered Auditor*

3 August 2004

**Profit and loss account**  
*for the year ended 31 May 2004*

	<i>Note</i>	<b>2004</b> £	2003 £
<b>Turnover</b>	2	<b>428,608</b>	239,755
Cost of sales (including exceptional items £nil (2003: £293,048))	4	<b>(117,461)</b>	(398,862)
<b>Gross profit/(loss)</b>		<b>311,147</b>	(159,107)
Distribution costs		<b>(1,261)</b>	(2,552)
Administrative expenses:			
Before development costs		<b>(473,479)</b>	(617,644)
Development costs		<b>(123,349)</b>	(350,606)
Total administrative expenses		<b>(596,828)</b>	(968,250)
Other operating income	3	<b>29,970</b>	-
<b>Operating loss</b>		<b>(256,972)</b>	(1,129,909)
Interest receivable and similar income	7	<b>7,763</b>	6,677
<b>Loss on ordinary activities before taxation</b>	2-7	<b>(249,209)</b>	(1,123,232)
Tax on loss on ordinary activities	8	<b>119,685</b>	158,850
<b>Loss on ordinary activities after taxation and retained for the financial year</b>		<b>(129,524)</b>	(964,382)
<b>Loss per ordinary share</b>			
<b>Basic and diluted</b>	22	<b>(1.36p)</b>	(10.86p)

All amounts relate to continuing activities.

The company has no recognised gains or losses in either the current or preceding year other than those reported above and therefore no statement of total recognised gains and losses has been presented.

**Balance sheet**  
*at 31 May 2004*

	<i>Note</i>	2004	2003
		£	£
<b>Fixed assets</b>			
Intangible assets	<i>9</i>	<b>8,540</b>	10,758
Tangible assets	<i>10</i>	<b>56,037</b>	97,893
		<u>64,577</u>	<u>108,651</u>
<b>Current assets</b>			
Stocks	<i>11</i>	<b>88,683</b>	70,068
Debtors	<i>12</i>	<b>506,011</b>	294,387
Cash at bank and in hand		<b>2,707,839</b>	178,175
		<u>3,302,533</u>	<u>542,630</u>
<b>Creditors: amounts falling due within one year</b>	<i>13</i>	<b>(97,075)</b>	(77,608)
<b>Net current assets</b>		<u>3,205,458</u>	<u>465,022</u>
<b>Net assets</b>		<u>3,270,035</u>	<u>573,673</u>
<b>Capital and reserves</b>			
Called up share capital	<i>15</i>	<b>132,158</b>	93,799
Share capital to be issued	<i>15</i>	<b>4,750</b>	-
Share premium account	<i>16</i>	<b>4,750,552</b>	1,967,775
Other reserves	<i>16</i>	<b>520,399</b>	520,399
Profit and loss account	<i>16</i>	<b>(2,137,824)</b>	(2,008,300)
<b>Equity shareholders' funds</b>		<u>3,270,035</u>	<u>573,673</u>

These financial statements were approved by the board of directors on 3 August 2004 and were signed on its behalf by:

**K D'Silva**  
*Chairman*

**JJ Faria**  
*Director*

**Cash flow statement**  
*for the year ended 31 May 2004*

	<i>Note</i>	<b>2004</b>	2003
		£	£
<b>Reconciliation of operating loss to net cash flow from operating activities</b>			
Operating loss		(256,972)	(1,129,909)
Depreciation charge		42,674	41,628
Amortisation charge		2,218	2,218
Profit on sale of fixed assets		-	(100)
(Increase)/decrease in stocks		(18,615)	268,103
Increase in debtors		(37,974)	(58,703)
Increase/(decrease) in creditors		19,467	(40,834)
<b>Net cash outflow from operating activities</b>		<b>(249,202)</b>	<b>(917,597)</b>
		<b>2004</b>	2003
		£	£

**Cash flow statement**

<b>Cash flow from operating activities</b>		<b>(249,202)</b>	<b>(917,597)</b>
<b>Return on investments and servicing of finance</b>	<i>19</i>	<b>7,763</b>	<b>6,677</b>
<b>Taxation</b>		<b>278,535</b>	<b>-</b>
<b>Capital expenditure</b>	<i>19</i>	<b>(818)</b>	<b>(9,045)</b>
Cash inflow/(outflow) before financing and management of liquid resources		<b>36,278</b>	<b>(919,965)</b>
<b>Management of liquid resources</b>	<i>19</i>	<b>(2,635,000)</b>	<b>-</b>
<b>Financing</b>	<i>19</i>	<b>2,493,386</b>	<b>958,545</b>
<b>(Decrease)/increase in cash in the year</b>		<b>(105,336)</b>	<b>38,580</b>

	<b>2004</b>	2003
	<b>£</b>	£
<b>Reconciliation of net cash flow to movement in net funds</b>		
(Decrease)/increase in cash in the year	<b>(105,336)</b>	38,580
Increase in liquid resources	<b>2,635,000</b>	-
	<hr/>	<hr/>
Movement in net funds in the year	<b>2,529,664</b>	38,580
Net funds at the start of the year	20 <b>178,175</b>	139,595
	<hr/>	<hr/>
Net funds at the end of the year	20 <b>2,707,839</b>	178,175
	<hr/> <hr/>	<hr/> <hr/>

**Reconciliation of movements in shareholders' funds**  
*for the year ended 31 May 2004*

	<b>2004</b>	2003
	<b>£</b>	£
Loss for the financial year	<b>(129,524)</b>	(964,382)
New share capital subscribed (net of issue costs)	<b>2,825,886</b>	958,545
	<hr/>	<hr/>
Net addition to/(reduction in) shareholders' funds	<b>2,696,362</b>	(5,837)
Opening shareholders' funds	<b>573,673</b>	579,510
	<hr/>	<hr/>
Closing shareholders' funds	<b>3,270,035</b>	573,673
	<hr/> <hr/>	<hr/> <hr/>

## Notes

*(forming part of the financial statements)*

### 1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements.

#### *Basis of preparation*

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

#### *Intangible fixed assets and amortisation*

Expenditure on patents is capitalised and amortised to nil by equal annual instalments over the useful economic life of seven and a half years.

#### *Tangible fixed assets and depreciation*

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Plant and machinery	-	20% per annum
Fixtures and fittings	-	25% per annum

#### *Foreign currencies*

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

#### *Leases*

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

#### *Government grants*

Revenue grants are credited to the profit and loss account, and included within other operating income, so as to match them with expenditure to which they relate.

#### *Post retirement benefits*

The company contributes to specific employees' personal pension schemes. The amount charged to the profit and loss account represents the contributions payable to employees personal pension schemes during the accounting year.

***Employee share schemes***

The cost of awards to employees that take the form of shares or rights to shares are recognised over the period of the employees related performance. Where there are no performance criteria the cost is recognised when the employee becomes unconditionally entitled to shares.

***Research and development***

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

***Stocks***

Stocks are stated at the lower of cost and net realisable value. In determining the cost of raw materials and consumables the standard purchase price is used. For work in progress, cost is taken as production cost, which includes an appropriate proportion of attributable overheads.

***Taxation***

The charge for taxation is based on the loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised without discounting in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

***Cash***

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

***Liquid resources***

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise term deposits of less than one year.

***Turnover***

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers during the year.

**2 Analysis of turnover and loss on ordinary activities before taxation**

Turnover and loss on ordinary activities before taxation is wholly attributable to the principal activity of the company.

Turnover by destination is analysed as follows:

	2004	2003
	£	£
<i>By geographical market:</i>		
United Kingdom	407,931	237,188
Rest of European Community	15,177	2,567
United States of America	5,500	-
	<u>428,608</u>	<u>239,755</u>

Turnover by origin, net assets and profit before interest and tax all relate to the UK.

**3 Loss on ordinary activities before taxation**

	2004	2003
	£	£
<b>Loss on ordinary activities before taxation is stated</b>		
<i>after charging</i>		
Auditors' remuneration:		
- audit	14,000	12,000
- other	21,500	5,000
Depreciation of owned tangible fixed assets	42,674	41,628
Research and development expenditure	123,349	350,606
Amortisation of patents and licences	2,218	2,218
Rentals payable under operating leases		
- land and buildings	42,756	5,288
Exchange losses	1,660	-
<i>after crediting</i>		
Profit on sale of fixed assets	-	100
Exchange gains	-	479
Government grants	29,970	-
	<u>29,970</u>	<u>-</u>

**4 Exceptional items**

Following Formula 1 regulatory changes introduced during the previous year which restricted the supply of products to that market, the directors decided to terminate all ongoing Formula 1 development. This resulted in a Formula 1 stock write down of £293,048 in the prior year.

**5 Remuneration of directors**

Full disclosure of directors' emoluments, share options and directors' pension entitlements which form part of the package as well as remuneration, interests and transactions is given in the Report on directors' remuneration on pages 9 to 11.

**6 Staff numbers and costs**

The average number of persons employed by the company (including directors) during the year, analysed by category, was as follows:

	<b>Number of employees</b>	
	<b>2004</b>	2003
Directors	<b>5</b>	3
Other employees	<b>10</b>	12
	<u><b>15</b></u>	<u>15</u>
	<u><u><b>15</b></u></u>	<u><u>15</u></u>

The aggregate payroll costs of these persons were as follows:

	<b>2004</b>	2003
	<b>£</b>	£
Wages and salaries	<b>292,058</b>	315,842
Social security costs	<b>25,662</b>	30,574
Other pension costs (see note 18)	<b>2,960</b>	2,540
	<u><b>320,680</b></u>	<u>348,956</u>
	<u><u><b>320,680</b></u></u>	<u><u>348,956</u></u>

**7 Other interest receivable**

	<b>2004</b>	2003
	<b>£</b>	£
Bank interest receivable	<b>7,763</b>	6,677
	<u><b>7,763</b></u>	<u>6,677</u>
	<u><u><b>7,763</b></u></u>	<u><u>6,677</u></u>

## 8 Taxation

### Analysis of credit in year

	2004	2003
	£	£
<i>UK corporation tax</i>		
Current tax on income for the year	-	-
Research and development tax repayment	(119,685)	(158,850)
	<u>(119,685)</u>	<u>(158,850)</u>
	<u><u>(119,685)</u></u>	<u><u>(158,850)</u></u>

Details of the unrecognised deferred tax asset are included in note 14.

### *Factors affecting the tax charge for the current period*

The current tax charge for the year is lower (*2003: higher*) than the standard rate of corporation tax in the UK of 30%. The differences are explained below:

	2004	2003
	£	£
<i>Current tax reconciliation</i>		
Loss on ordinary activities before tax	(249,209)	(1,123,232)
Current tax at standard rate of 30%	<u>(74,763)</u>	<u>(336,970)</u>
<i>Effects of:</i>		
Expenses not deductible for tax purposes	665	450
Capital allowances for period in excess of depreciation	5,257	4,496
Tax losses incurred in the period	68,841	332,024
Research and development tax repayment	(119,685)	(158,850)
Total current tax credit (see above)	<u>(119,685)</u>	<u>(158,850)</u>
	<u><u>(119,685)</u></u>	<u><u>(158,850)</u></u>

### *Factors that may affect future tax charges*

The effective tax rate in future years is expected to be below the standard rate of corporation tax in the UK due principally to historical losses which have been carried forward.

**9 Intangible fixed assets**

	<b>Patents and licences £</b>
<i>Cost</i>	
At beginning and end of year	16,637
	-----
<i>Amortisation</i>	
At beginning of year	5,879
Charge for year	2,218
	-----
At end of year	8,097
	-----
<i>Net book value</i>	
<b>At 31 May 2004</b>	<b>8,540</b>
	=====
At 31 May 2003	10,758
	=====

Patent costs are amortised over seven and a half years.

**10 Tangible fixed assets**

	<b>Plant and machinery £</b>	<b>Fixtures and fittings £</b>	<b>Totals £</b>
<i>Cost</i>			
At beginning of year	203,148	6,881	210,029
Additions	366	452	818
	-----	-----	-----
At end of year	203,514	7,333	210,847
	-----	-----	-----
<i>Depreciation</i>			
At beginning of year	107,957	4,179	112,136
Charge for year	40,533	2,141	42,674
	-----	-----	-----
At end of year	148,490	6,320	154,810
	-----	-----	-----
<i>Net book value</i>			
<b>At 31 May 2004</b>	<b>55,024</b>	<b>1,013</b>	<b>56,037</b>
	=====	=====	=====
At 31 May 2003	95,191	2,702	97,893
	=====	=====	=====

<b>11</b>	<b>Stocks</b>		
		<b>2004</b>	2003
		<b>£</b>	<b>£</b>
	Raw materials and consumables	<b>1,176</b>	-
	Work in progress	<b>87,507</b>	70,068
		<u><b>88,683</b></u>	<u>70,068</u>
		<u><u><b>88,683</b></u></u>	<u><u>70,068</u></u>
<b>12</b>	<b>Debtors</b>		
		<b>2004</b>	2003
		<b>£</b>	<b>£</b>
	Trade debtors	<b>155,157</b>	125,414
	Share capital unpaid	<b>332,500</b>	-
	Other debtors	<b>519</b>	-
	Prepayments and accrued income	<b>17,835</b>	10,123
	Research and development tax repayment	<b>-</b>	158,850
		<u><b>506,011</b></u>	<u>294,387</u>
		<u><u><b>506,011</b></u></u>	<u><u>294,387</u></u>
	All debtors fall due within one year.		
<b>13</b>	<b>Creditors: amounts falling due within one year</b>		
		<b>2004</b>	2003
		<b>£</b>	<b>£</b>
	Trade creditors	<b>52,703</b>	39,551
	Taxation and social security	<b>12,058</b>	16,690
	Accruals and deferred income	<b>32,314</b>	21,367
		<u><b>97,075</b></u>	<u>77,608</u>
		<u><u><b>97,075</b></u></u>	<u><u>77,608</u></u>

#### 14 Provisions for liabilities and charges

The elements of deferred taxation are as follows:

	2004 £	2003 £
Difference between accumulated depreciation and amortisation and capital allowances	(6,504)	7,036
Tax losses	(423,392)	(342,579)
Unrecognised deferred tax asset	<u>(429,896)</u>	<u>(335,543)</u>

The company has an unrecognised deferred tax asset at 31 May 2004 of £429,896 (2003: £335,543) relating to tax losses which the company can offset against future taxable profits. An element of historical losses brought forward at 1 June 2003 has been surrendered for tax credit relief to allow the submission of a research and development tax claim. The claim has resulted in the surrender of some historical losses carried forward and a £21,356 reduction in the unrecognised deferred tax asset at 31 May 2003 which was previously disclosed in the 2003 accounts as £335,543.

The deferred tax asset has not been recognised in the accounts because it is not possible to assess whether there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

#### 15 Called up share capital

	2004 £	2003 £
<i>Authorised</i>		
20,000,000 ordinary shares of £0.01 each	<u>200,000</u>	<u>200,000</u>
<i>Allotted, called up and fully paid</i>		
13,215,748 shares of £0.01 each (2003: 9,379,880 shares of £0.01 each)	<u>132,158</u>	<u>93,799</u>

On 24 May 2004 the directors resolved to allot 3,667,859 ordinary shares of £0.01 each. These shares were issued between 25 and 28 May 2004. In addition, a further 475,000 ordinary shares of £0.01 each will be allotted by 5 August 2004.

The allotment was pursuant to a placing of shares to institutional and other investors. The total consideration in respect of the above will be £2.9 million, including £332,500 in respect of the shares still to be issued, before costs of £167,529.

The funds raised will be applied to the company's capital investment programme, the expansion of its management and technical team and to provide working capital generally.

In addition, the company has issued 24,276 shares to non-executive directors and 20,000 shares to its financial advisor in lieu of consultancy fees. The premium on the issue of these shares was £30,558.

A further 123,733 shares were issued on the exercise of warrants as referred to below.

The new shares issued rank *pari passu* in all respects with the ordinary shares in issue including the same voting rights, rights to dividends, and their priority and amounts receivable on a winding up.

#### *Warrants*

On 4 December 2000, the date of admission to OFEX, 566,667 offer warrants and 615,799 financial arranger warrants were granted to the purchasers of the ordinary shares and the financial adviser respectively. One offer warrant was issued with every three ordinary shares purchased. The financial arranger warrants were issued to the financial adviser in lieu of consultancy fees.

The fair value attributable to the offer and financial arranger warrants were calculated on the date of issue as £212,500 and £307,899 respectively. When the warrants were granted, adjustments were made to reduce the share premium account and increase the warrant reserve in respect of both amounts. The offer warrant reserve, relates to the reduction in consideration received for the shares and the financial arranger warrant reserve relates to issue costs that would have been set off against the share premium account.

When the warrants are exercised the fair value of the warrants is transferred from the warrant reserve to the capital reserve and the premium credited to the share premium account in accordance with FRS 4.

The offer warrants were exercisable in the period until 3 years from 4 December 2000 the OFEX admission date. All offer warrants not exercised have now therefore expired.

There are 340,000 Financial Arranger Warrants remaining (*2003: 466,000*) at a price of £0.5 per ordinary share which may be exercised in the period ended 3 December 2005.

None of the warrants hold voting rights.

The Offer Warrants and the Financial Arranger Warrants have been exercised as follows:

	<b>Offer warrants</b>	<b>Arranger warrants</b>
	Number	Number
At 31 May 2003	146,770	466,000
Warrants exercised in the year	(2,733)	(121,000)
Warrants expired	(144,037)	(5,000)
At 31 May 2004	<u>-</u>	<u>340,000</u>

The Offer Warrants exercised during the year were priced at £0.70. The consideration received was £1,913.

The Financial Arranger Warrants exercised during the year were priced at £0.50. The consideration received was £60,500.

#### **Enterprise Management Incentive Scheme**

The company operates a share incentive scheme for the benefit of the directors and certain employees. All options are granted at the discretion of the Board. The scheme grants options to purchase ordinary shares of £0.01 each. No options were exercised in the period.

The options granted to directors, date of grant and exercise price and exercise periods under scheme are set out in the report on directors' remuneration on pages 9 to 11. In addition to the directors' share options, certain employees have been granted the following options:

<b>Date of grant</b>	<b>Number of share options granted</b>	<b>Number of share options expired</b>	<b>Exercise price</b>	<b>Exercise period</b>
19/12/02	149,233	(90,931)	£0.70	19/12/05-19/12/12
08/12/03	34,091	(34,091)	£0.88	19/12/06-19/12/13
08/03/03	120,000	-	£0.665	08/03/07-08/03/14

**16 Reserves**

	<b>Share premium account</b>	<b>Warrant reserve</b>	<b>Capital reserve</b>	<b>Profit and loss account</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
At beginning of year	1,967,775	279,289	241,110	(2,008,300)
Premium on issue of shares	2,561,380	-	-	-
Premium on shares to be issued	327,750	-	-	-
Premium on exercise of warrants	61,176	-	-	-
Transfer on exercise of warrants	-	(52,775)	52,775	-
Issue costs	(167,529)	-	-	-
Retained loss for the year	-	-	-	(129,524)
At end of year	<u>4,750,552</u>	<u>226,514</u>	<u>293,885</u>	<u>(2,137,824)</u>

**17 Commitments**

Annual commitments under non-cancellable operating leases are as follows:

	<b>Land and buildings 2004</b>	Land and buildings 2003
	<b>£</b>	<b>£</b>
Operating leases which expire:		
In the second to fifth years inclusive	<b>30,662</b>	5,288

**18 Pension scheme**

The company contributes to specific employees personal pension schemes. The pension cost charge for the year represents contributions payable by the company to the scheme and amounted to £2,960 (2003: £2,540).

There were no outstanding or prepaid contributions either at the beginning or end of the financial year.

**19 Analysis of cash flows**

	<b>2004</b>	2003
	<b>£</b>	£
<b>Returns on investments and servicing of finance</b>		
Interest received	7,763	6,677
	<u>7,763</u>	<u>6,677</u>
<b>Capital expenditure and financial investment</b>		
Purchase of tangible fixed assets	818	(9,145)
Sales of tangible fixed assets	-	100
	<u>818</u>	<u>(9,045)</u>
<b>Management of liquid resources</b>		
Cash placed on treasury deposit	(2,635,000)	-
	<u>(2,635,000)</u>	<u>-</u>
<b>Financing</b>		
Issue of ordinary share capital	38,359	14,643
Premium from issue of ordinary share capital (net of issue costs)	2,393,851	935,327
Premium on exercise of warrants	61,176	8,575
	<u>2,493,386</u>	<u>958,545</u>

**20 Analysis of net funds**

	At beginning of year	Cash flow	At end of year
	£	£	£
Cash at bank and in hand	178,175	(105,336)	72,839
Liquid resources	-	2,635,000	2,635,000
	<u>178,175</u>	<u>2,529,664</u>	<u>2,707,839</u>
	<u>178,175</u>	<u>2,529,664</u>	<u>2,707,839</u>

## 21 Related party disclosures

The results of the company include the following transactions with related parties:

Company/entity	Relationship	Purchase	2004 £	2003 £
April Training Executive Ltd	JJ Faria is a director and has a controlling interest	Administrative services	10,200	10,705
April Property Partnership	JJ Faria is a director and has a controlling interest	Rent	6,000	5,288

All purchases from related parties are conducted on an arms length basis under normal commercial trading terms.

At the year end £2,045 was owing to April Training Executive Limited (2003: £nil) and £587 to April Property Partnership (2003: £nil).

## 22 Loss on ordinary shares

The calculation of basic loss per ordinary share is based on the loss for the financial year divided by the weighted average number of shares in issue during the year.

Losses and number of shares used in the calculations of loss per ordinary share are set out below:

Basic	2004 £	2003 £
Loss after tax	(129,524)	(964,382)
Weighted average number of shares	9,506,297	8,882,861
Loss per share	<u>1.36p</u>	<u>10.86p</u>

The calculation of diluted loss per ordinary share is identical to that used for the basic loss per ordinary share. This is because the exercise of warrants and options would have the effect of reducing the loss per ordinary share and is therefore not dilutive under the terms of FRS14.

## Company information and advisors

Registered Number	03769702
Directors	Kevin D'Silva ( <i>Non-executive Chairman</i> ) Julio J Faria ( <i>Managing Director</i> ) Geoffrey Gould ( <i>Sales &amp; Marketing Director</i> ) Professor David Thomas Clark ( <i>Non executive Director</i> ) Peter Holland ( <i>Non executive Director</i> )
Registered and head office	April House, Tarvin Road Frodsham Cheshire WA6 6XN
Nominated adviser and broker	John East & Partners Limited Crystal Gate 28-30 Worship Street London EC2A 2AH
Auditors	KPMG Audit Plc St James' Square Manchester M2 6DS
Solicitors to the Company	Halliwells LLP St James' Court Brown Street Manchester M2 2JF
Bankers	Barclays Bank plc 125 Main Street Frodsham Cheshire WA6 7AD
Registrars	Capita IRG plc Bourne House 34 Beckenham Road Beckenham Kent BR3 4TU
Financial public relations advisers	Gresham PR 21 Bloomsbury Way London WC1A 2TH