

**HYDRODEC GROUP PLC**

**CONSOLIDATED FINANCIAL  
STATEMENTS**

**FOR THE YEAR ENDED**

**31 DECEMBER 2006**

Company no 5188355

# HYDRODEC GROUP PLC

## CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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Company registration number: 5188355

Registered office: 84 Grosvenor St,  
London W1J 3JZ  
United Kingdom

Directors: J H Gunn (Non-executive chairman)  
B J Sheeran (Non-executive deputy chairman)  
M D McNamara (Executive chief operating officer)  
R D Sargent (Financial director)  
B J Bamonte (Non-executive director)

Secretary: R D Sargent

Nominated adviser and broker: Numis Securities Ltd  
Cheapside House  
138 Cheapside  
London  
EC2V 6LH

Bankers: Coutts & Co  
440 The Strand  
London WC2R 0QS

Solicitors: Norton Rose  
Kempson House  
Camomile Street  
London EC3A 7AN

Registrars: Capita Registrars Ltd  
The Registry  
34 Beckenham Road  
Beckenham  
Kent BR3 4TU

Auditors: Grant Thornton UK LLP  
Registered Auditors and Chartered Accountants  
Grant Thornton House  
Melton Street  
Euston Square  
London NW1 2EP

# HYDRODEC GROUP PLC

## CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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# HYDRODEC GROUP PLC

## CHAIRMAN'S STATEMENT

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I am pleased to present Hydrodec's accounts for the year ended 31 December 2006. Hydrodec's technology is an oil refining process that produces new speciality oils, using spent oil as the primary feedstock. The process also removes dangerous contaminants such as PCB's from oil and similar fluids. The technology can be applied to many speciality oils, but initially the Company is concentrating on the transformer oil industry. Old transformer oil that has been refined through the Hydrodec process becomes Superfine transformer oil.

2006 has seen major developments within Hydrodec. The Australian operations have generated enormous interest and profile within the transformer industry and as a result of this interest, long-term agreement is now in place with a major transformer manufacturer, and negotiations are continuing with a number of others. The Company has also made tremendous progress in a short period of time within the key US transformer oil market including, at the end of the year, receiving planning permission for the first US plant, in Canton, Ohio.

### **Year ended 31 December 2006 results**

Turnover for the year increased nearly 200% to £844,867 (2005: £288,638), with the overall operating loss more than halving to £2,903,094 (2005: £6,076,609). The operating loss includes £970,858 of non-cash items due to the write-off of options granted during the year, depreciation and the goodwill write-off of the Hydrodec licence, leaving a net operating cash outflow of £2,113,630 (2005: £2,308,107). Net assets fell to £10,963,311 (2005: £12,135,186), including cash balances of £891,913 (2005: £3,161,329).

On 13 October 2006, the Company issued 6,000,000 new ordinary shares, raising over £1.68 million gross through an institutional placing to fund infrastructure development at the Young plant and on-going US development.

### **Business developments**

Following the successful commissioning on 24 April of the 20,000 litre per day capacity refining plant in Young, New South Wales, 2006 saw the continued commercialisation of the technology in Australia. In March 2006, TransGrid, the New South Wales power transmission authority, issued a standing purchase order stating Hydrodec is now qualified to treat its used PCB contaminated transformers. Additionally, significant purchase orders for Superfine were received, including the refining of 230,000 litres of low level PCB contaminated oil for a South Australian Utility and supply of more than 200,000 litres of oil for refining from SP AusNet of Victoria. Superfine orders also came from a New South Wales utility and a service company in Southern Australia for transformer retro-fills.

Agreement was reached in February 2007 (following the period covered by these accounts) with Schneider Australia, who have agreed in principle to allocate up to 75% of its annual new transformer oil purchase in Australia, to Superfine. This is an expected uptake of 3,000 litres of Superfine per day that represents up to 15% of Hydrodec's production capacity in Australia. Schneider Electric is a key manufacturer of distribution transformers in Australia, supplying to major power utilities across the country and is one of Australia's larger transformer oil purchasers. This order has a potentially significant impact on Hydrodec's credibility within the market and will greatly help future negotiations with other clients.

### **Technological developments**

On-going product and process research and development carried out through July and August 2006 in response to customer inquiry identified a means of enhancing the technical quality of Superfine oil. This enhanced quality has been delivered by adjustment of operating conditions and minor modification of equipment in the process train within the existing plant. We are confident that the resulting Superfine product will meet all the demands of customers in the future.

### **Operational Capacity**

Hydrodec's capacity, knowledge and skills are embodied by the Company's staff and systems. Commissioning of the 20,000 litre per day capacity plant in April was paralleled by the establishment of the human and systems resources required for continuous production of Superfine. During 2006, Hydrodec graduated from start-up to fully

established transformer oil refiner, distributor and marketer. The Australian operations for Superfine production are now fully established and structured to be able to support and sustain expansion to the US and beyond.

### **Intellectual Property ('IP')**

The IP underlying Hydrodec's market advantage was enhanced during the year. In the key of areas of process operating systems, auxiliary plant and operating facilities, Hydrodec added to the knowledge base of the company. Improvements to the IP base reinforce the market leading technology advantage underlying Hydrodec's strategy in the specialty oils marketplace.

### **US expansion**

The key to Hydrodec's future expansion is the US, the world's biggest transformer oil market. On-going research and market analysis throughout 2006 culminated in Hydrodec receiving statutory planning consent for the establishment of its first US plant in Canton, Ohio on 07 December 2006. Canton was chosen due to its location in one of the major industrial regions in the USA, close to both the suppliers of feedstock oil, a skilled workforce and potential Superfine customers.

The State of Ohio and the City of Canton have also provided a package of incentives to Hydrodec. These include, from the State, a Business Development grant of up to US\$100,000, a Workforce Development grant of up to US\$65,000, a grant for off site infrastructure of up to US\$400,000 and US\$539,300 of State Job Creation Tax Credits. Incentives provided by the City of Canton include a Job Creation Program incentive valued at c.US\$210,938, Net Profits Tax incentive valued at c.US\$229,640, and an US\$437,756 Enterprise Zone Tax Abatement over ten years.

The Company has secured an option to acquire a production site located in an industrial park within Canton City limits. The site has direct access to interstate rail and road transport corridors. Concept planning for the facility is near complete and detailed design is underway. Order placement for long lead equipment and commencement of construction site works is scheduled for Q2 2007. Commissioning of the new facility is expected during the first half of 2008. Finalisation of the production facility location and commissioning dates has also enabled the acceleration of market development and product pre-sales activities. The site will have a production capacity of up to 80,000 litres of Superfine per day, a quadrupling of Hydrodec's existing Superfine production capacity.

### **The future**

The US market is key to the success of Hydrodec and the feedback from the transformer oil industry to the environmental, sustainability and greenhouse benefits that Hydrodec's technology provides has been tremendously encouraging. By using an existing used resource and then turning it into a supply of the highest quality new transformer oil, the Company achieves the very essence of sustainability.

The multiplying of our production capacity that the US gives will have significant financial benefits for the company and should give us the economic and industry credibility to consider other major markets for transformer oils around the world.

A key feature we have seen during negotiations with customers in 2006, both US and Australian, has been their interest in Hydrodec's ability to maintain supply of Superfine independent of world crude oil price and availability fluctuations. In today's uncertain geo-political climate, a secure price and guaranteed supply of oil is a key tenet of future planning for companies within the industry. That Hydrodec can provide this from a sustainable green source, creating a virtuous circle for the transformer manufacturer, the utility and their customers, bodes very well for the Company's future.

John Gunn  
Non-executive Chairman  
8 March 2007

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

The directors present their report together with the audited financial statements for the period ended 31 December 2006.

### Principal activities, name and business review

The group's principal activity is the commercialisation of the HydroDec Technology which is a patented technology for the re-refining of used transformer oils and creating new Superfine Oil.

The directors believe that returns for HydroDec stakeholders will be derived from market-driven, environmentally sustainable outcomes. The review of the business is included in the Chairman's Statement.

The key business risks associated with the business is the development of Superfine Oil as an acceptable alternative to the refined product, and the key financial risk is the management of cash during this development phase for the group.

### Results and dividends

The consolidated income statement for the year is set out on page 12. No dividend has been declared or is proposed for the period.

### Substantial interests

In addition to the shareholdings shown under directors' interests below, the company is aware of the following interests in 3% or more of the company's issued share capital at 28 February 2007.

	<b>Ordinary 0.5p shares</b>	<b>Percentage holding</b>
Virotec Investments Pty Limited	<b>60,000,000</b>	32.5%
WB Nominees Limited	<b>16,036,699</b>	8.7%
Mellon Nominees (UK) Limited	<b>13,027,286</b>	7.1%
HSBC Global Custody Nominee (UK) Limited	<b>10,082,000</b>	5.5%
Nutraco Nominees Limited	<b>9,740,643</b>	5.3%
Hotham Holdings Limited	<b>7,250,000</b>	3.9%
Roy Nominees Limited	<b>7,000,000</b>	3.8%

The company is not aware of any other person that has reported an interest of 3% or more of the company's ordinary shares.

### Directors

The directors who served during the period are set out below, together with their beneficial interests in the ordinary shares of the company:

	<b>31 December 2006</b>		<b>1 January 2006</b>	
	<b>Ordinary shares of 0.5p each</b>	<b>Share options of 0.5p each</b>	<b>Ordinary shares of 0.5p each</b>	<b>Share options of 0.5p each</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
J H Gunn	<b>4,637,500</b>	<b>2,000,000</b>	4,637,500	2,000,000
B J Sheeran	-	<b>2,000,000</b>	-	2,000,000
M D McNamara	-	<b>5,000,000</b>	-	5,000,000
R D Sargent	<b>1,000,000</b>	<b>1,500,000</b>	2,600,000	500,000
B J Bamonte	-	<b>2,000,000</b>	-	-

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

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### Directors (continued)

The exercise price and earliest and latest dates of exercise of share warrants and share options is as follows:

	<b>Share options</b>	<b>Exercise price (pence)</b>	<b>Earliest exercise date</b>	<b>Latest exercise date</b>
J H Gunn	<b>2,000,000</b>	<b>11.50p</b>	29 April 2007	28 April 2015
B J Sheeran	<b>2,000,000</b>	<b>11.50p</b>	29 April 2007	28 April 2015
M D McNamara	<b>5,000,000</b>	<b>11.50p</b>	15 July 2005	28 April 2015
R D Sargent	<b>500,000</b>	<b>11.50p</b>	29 April 2007	28 April 2015
R D Sargent	<b>1,000,000</b>	<b>26.25P</b>	22 Dec 2008	21 Dec 2016
B Bamonte	<b>2,000,000</b>	<b>26.25p</b>	22 Dec 2008	21 Dec 2016

The share price was 25.0p on 1 January 2006 and 26.5p on 31 December 2006, with a high and low during the year of 37.5p and 24.5p respectively.

### Employee involvement

The Group's policy is to encourage involvement at all levels, as it believes this is essential for the success of business.

### Creditor payment policy

The company's current policy and practice concerning the payment of suppliers is to settle terms of payment when agreeing the terms of the transactions, to ensure that the suppliers are aware of the terms and to abide by the agreed terms. The holding company's creditor days at 31 December 2006 were nil (2005: nil) days.

### Financial risk management objectives and policies

The company uses various financial instruments which include cash, trade debtors, trade creditors and amounts due to group undertakings that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the company's operations. The existence of these financial instruments exposes the company to a number of financial risks, which are described in more detail below.

The main risks arising from the company's financial instruments are currency risk, interest rate risk, credit risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below. These policies have remained unchanged from previous years.

### Currency risk

The company is exposed to translation and transaction foreign exchange risk.

Approximately 99% of the company's purchases during the year were transacted in Australian dollars. The company does not adopt a prescribed policy to eliminate currency exposures but does purchase Australian dollars to hold for the purpose of settling these liabilities from time to time when rates are favourable.

The company's financial assets and liabilities in currencies other than sterling are set out in note 15. Foreign exchange differences on retranslation of these liabilities are taken to the profit and loss account of the company for monetary items and the exchange reserve for investment amounts.

**Financial risk management objectives and policies (continued)**

**Liquidity risk**

The company seeks to manage financial risk by ensuring sufficient liquidity is available to meet foreseeable needs and to invest cash assets safely and profitably.

The company's policy throughout the year has been to achieve this objective through management's day to day involvement in business decisions rather than through setting maximum or minimum liquidity ratios.

**Interest rate risk**

The company finances its operations through retained profits.

The interest rate exposure of the financial assets and liabilities of the company as at 31 December 2006 is shown in the balance sheet. The balance sheet includes trade debtors and creditors as these do not attract interest and are therefore subject to fair value interest rate risk.

**Credit risk**

The company's principal financial assets are cash and trade debtors. The credit risk associated with cash is limited as the counterparties have high credit ratings assigned by international credit-rating agencies. The principal credit risk arises, therefore, from trade debtors.

In order to manage credit risk management set limits for customers based on a combination of payment history and third party credit references. Credit limits are reviewed by the financial controller on a regular basis in conjunction with debt ageing and collection history

**Statement of directors' responsibilities**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards as adopted by the European Union.

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 the group and of the profit or loss of the group or company for that period. In preparing these 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; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In so far as the directors are aware:

- there is no relevant audit information of which the company's auditors are unaware; and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

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### **Statement of directors' responsibilities (continued)**

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### **Auditors**

Grant Thornton UK LLP offer themselves for reappointment as auditors in accordance with section 385 of the Companies Act 1985.

BY ORDER OF THE BOARD

R D Sargent  
Company Secretary

8 March 2007

This statement outlines the main corporate governance practices that were introduced during the financial year.

### **Role of the Board**

The Board's primary role is the protection and enhancement of long-term shareholder value. To fulfil this role, the Board is responsible for the overall corporate governance of the consolidated entity including its strategic direction, establishing goals for management and monitoring the achievement of these goals.

Management's role is to implement the strategic plan established by the Board and to work within the corporate governance and internal control parameters established by the Board.

### **Board processes**

To assist in the execution of its responsibilities, the Board has established an Audit Committee and a Remuneration Committee and a framework for the management of the consolidated entity including a system of internal control.

The full Board will hold meetings regularly and at any other time as may be necessary to address any specific significant matters that may arise.

The agenda for board meetings is prepared in conjunction with the Chairman. Submissions are circulated in advance. Executives are regularly involved in board discussions and directors have other opportunities, including visits to operations, for contact with a wider group of employees.

The Board conducts an annual review of its processes to ensure that it is able to carry out its functions in the most effective manner.

### **Composition of the Board**

The names of the directors of the company in office at the date of this Statement are set out in this Directors' Report. The composition of the Board is determined using the following principles:

- the Board should comprise no more than six directors. This number may be increased where it is felt that additional expertise is required in specific areas, or when an outstanding candidate is identified,
- the role of Chairman is to be filled by a non-executive director
- the Board should comprise a majority of non-executive directors,
- the Board should have enough directors to serve on various committees of the Board without overburdening the directors or making it difficult for them to fully discharge their responsibilities,
- directors appointed by the Board are subject to election by shareholders at the following annual general meeting and thereafter directors are subject to re-election at least every three years.

### **Conflict of interest**

Directors must keep the Board advised on an ongoing basis, of any interest that could potentially conflict with those of the company. Where the Board believes that a significant conflict exists, the director concerned is not present at the meeting whilst the item is considered.

### **Independent professional advice and access to company information**

Each director has the right of access to all relevant company information and to the company's executives and, subject to prior consultation with the Chairman, may seek independent professional advice at the company's expense. A copy of any advice received by the director is to be made available to all other members of the Board.

### **Audit Committee**

The role of the Audit Committee is documented in a Charter that has been approved by the Board of Directors. The role of the Committee is to advise the Board on the maintenance of a framework of internal control and appropriate ethical standards for the management of the consolidated entity. It also gives the Board of Directors additional assurance regarding the quality and reliability of financial information prepared for use by the Board in determining policies or for inclusion in the financial report.

The members of the Audit Committee are J Gunn (Chairman) and B Bamonte.

The external auditors, the Executive Chairman, and the Company Secretary, may be invited to Audit Committee meetings at the discretion of the Committee. The Committee plans to meet at least four times during the year.

The responsibilities of the Audit Committee include:

- reviewing the annual and half year financial statements and other financial information distributed externally,
- reviewing any new accounting policies to ensure compliance with International Financial Reporting Standards and generally accepted accounting principles,
- reviewing audit reports to ensure that where major deficiencies or breakdowns in controls or procedures have been identified appropriate and prompt remedial action is taken by management
- reviewing the nomination and performance of the auditor,
- considering whether non-audit services provided by the external auditor are consistent with maintaining the external auditor's independence,
- liaising with the external auditors and ensuring that the annual audit and half-year review are conducted in an effective manner,
- monitoring the establishment of an appropriate internal control framework and considering enhancements, and
- monitoring the procedures in place to ensure compliance with all other regulatory requirements,

The Audit Committee reviews the performance of the external auditors on an annual basis and plans to meet with them during the year as required to discuss audit planning, any potential changes in accounting policies or related accounting issues, any issues arising from the half year review or full year audit and any other special matters or investigations deemed necessary by the Board.

### **Remuneration Committee**

The Remuneration Committee's responsibilities include:

- reviewing and making recommendations to the Board on remuneration packages and policies applicable to the Chairman, the Executive Chairman, Chief Financial Officer and other Senior Executives of the Company,
- making recommendations to the Board on the composition of the directors on the Board having regard to the candidate's relevant experience and expertise,
- evaluating the board's performance and consideration of succession issues,
- making recommendations to the Board on guidelines and policies for the structuring of employees remuneration packages (e.g. share option schemes, incentive performance, packages)
- endeavouring to ensure that remuneration levels are competitively set to attract and retain the most qualified and experienced directors and senior executives with the ability to obtain independent advice on the appropriateness of remuneration packages given trends in comparative companies both locally and internationally.

The committee consists of J Gunn (Chairman) and B Sheeran. The membership of the committee will be reviewed by the Board on an annual basis.

### **The role of Shareholders**

The Board of Directors aims to ensure that the shareholders are informed of all major developments affecting the consolidated entity's state of affairs. Information is communicated to shareholders as follows:

- the Board ensures that the full annual financial report is sent to all shareholders,
- proposed major changes in the consolidated entity which may impact on share ownership rights are submitted to a vote of shareholders, and
- notices of all meetings of shareholders are sent to all shareholders.

The Board encourages full participation of shareholders at the Annual General Meeting to ensure a high level of accountability and identification with the consolidated entity's strategy and goals. Important issues are presented to the shareholders as separate resolutions. The shareholders are requested to vote on the appointment of directors, the granting of equity to directors and changes to the constitution. Copies of the constitution are available to any shareholder who requests it.

The company's auditors also attend the Annual General Meeting and are available for discussion in relation to the consolidated entity's financial statements.

## **REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF HYDRODEC GROUP PLC**

We have audited the group financial statements of Hydrodec Group plc for the year ended 31 December 2006 which comprise the principal accounting policies, the group income statement, the group balance sheet, the group cash flow statement, the group statement of changes in shareholders' equity, and notes 1 to 18. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Hydrodec Group plc for the year ended 31 December 2006.

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' responsibilities for preparing the Annual Report and the group financial statements in accordance with United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the group financial statements give a true and fair view, and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we also report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Directors' Report, Corporate Governance Statement and the Chairman's Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

# **REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF HYDRODEC GROUP PLC**

## **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the group'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 group financial statements 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 group financial statements.

## **Opinion**

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2006 and of its loss for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements for the year ended 31 December 2006.

**GRANT THORNTON UK LLP  
REGISTERED AUDITORS  
CHARTERED ACCOUNTANTS**

**LONDON  
8 MARCH 2007**

Note: The maintenance and integrity of the Hydrodec Group PLC website is the responsibility of the directors: the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

# HYDRODEC GROUP PLC

## CONSOLIDATED INCOME STATEMENT

For the year ended 31 DECEMBER 2006

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	Note	2006 £	2005 £
Revenue		844,867	288,638
Cost of sales		<u>(411,818)</u>	<u>(173,183)</u>
Gross profit		433,049	115,455
Administrative expenses	2,3	<u>(3,297,875)</u>	<u>(6,192,064)</u>
<b>Operating loss</b>		<b>(2,864,826)</b>	<b>(6,076,609)</b>
Interest receivable		60,932	90,099
Interest payable		<u>(8,990)</u>	<u>-</u>
<b>Loss on ordinary activities before taxation</b>	2	<b>(2,812,884)</b>	<b>(5,986,510)</b>
Tax on loss on ordinary activities	5	<u>-</u>	<u>-</u>
<b>Loss for the period</b>		<b><u>(2,812,884)</u></b>	<b><u>(5,986,510)</u></b>
<b>Loss per share - basic and diluted</b>	6	<b><u>(1.56p)</u></b>	<b><u>(3.72p)</u></b>

All transactions arise from continuing operations.

The accompanying accounting policies and notes form an integral part of these financial statements.

# HYDRODEC GROUP PLC

## CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2006

	Note	2006 £	2005 £
<b>Non-current assets</b>			
Property, plant and equipment	7	<b>3,620,343</b>	2,109,480
Intangible assets	8	<b>6,817,203</b>	7,341,603
		<b>10,437,546</b>	9,451,083
<b>Current assets</b>			
Trade and other receivables	9	<b>184,612</b>	203,712
Inventories	10	<b>75,361</b>	54,434
Cash and cash equivalents		<b>945,938</b>	3,260,612
		<b>1,205,911</b>	3,518,758
<b>Current liabilities</b>			
Trade and other payables	11	<b>(418,840)</b>	(680,158)
<b>Net current assets</b>			
		<b>787,071</b>	2,838,600
<b>Non-current liabilities</b>			
Finance lease liabilities		<b>(261,306)</b>	(154,497)
		<b>10,963,311</b>	12,135,186
<b>Capital and reserves</b>			
Called up share capital	12	<b>923,227</b>	893,227
Share premium account		<b>16,891,306</b>	15,325,306
Share options reserve		<b>2,140,052</b>	1,913,889
Profit and loss account		<b>(8,806,258)</b>	(5,993,374)
Foreign exchange reserve		<b>(185,016)</b>	(3,862)
<b>Total equity</b>		<b>10,963,311</b>	12,135,186

The financial statements were approved by the Board of Directors on 8 March 2007 and were signed on its behalf by:

**R D Sargent - Director**

The accompanying accounting policies and notes form an integral part of these financial statements.

# HYDRODEC GROUP PLC

## CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 DECEMBER 2006

	2006 £	2005 £
<b>Cashflows from operating activities</b>		
Loss after tax	(2,812,884)	(5,986,510)
Decrease/(increase) in amounts receivable	19,100	(25,687)
Decrease in amounts payable	(179,847)	(669,215)
Increase in inventories	(20,927)	(54,434)
Depreciation	220,295	84,189
Loss on disposal of property, plant and equipment	44,845	-
Amortisation of other intangible assets	524,400	524,400
Finance costs	(51,942)	(90,099)
Foreign exchange movement	(73,843)	(7,417)
Share based payment expense	226,163	1,913,889
Impairment of goodwill	-	2,002,777
<b>Net cash outflow from operating activities</b>	<b>(2,104,640)</b>	<b>(2,308,107)</b>
<b>Cashflows from investing activities</b>		
Purchase of investment (including costs)	-	(1,851,222)
Purchase of property plant and equipment	(1,683,314)	(951,307)
Overdraft acquired	-	(122,747)
Finance lease interest paid	(8,990)	-
Bank interest and other income received	60,932	90,099
<b>Net cash outflow from investing activities</b>	<b>(1,631,372)</b>	<b>(2,835,177)</b>
<b>Cashflows from financing activities</b>		
Issue of new shares	1,680,000	5,464,896
Costs of share issue	(84,000)	(146,346)
Repayment of lease liabilities	(129,404)	(28,200)
<b>Net cash inflow from financing</b>	<b>1,466,596</b>	<b>5,290,350</b>
<b>(Decrease)/increase in cash and cash equivalents</b>	<b>(2,269,416)</b>	<b>147,066</b>
<b>Opening cash and cash equivalents</b>	<b>3,161,329</b>	<b>3,014,263</b>
<b>Closing cash and cash equivalents</b>	<b>891,913</b>	<b>3,161,329</b>

# HYDRODEC GROUP PLC

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 DECEMBER 2006

	Share capital £	Share premium £	Foreign exchange reserve £	Profit and loss account £	Share option reserve £	Total £
At 1 January 2005	782,500	10,117,483	3,555	(6,864)	-	10,896,674
Recognition of share-based payment	-	-	-	-	1,913,889	1,913,889
Exchange differences on translation of foreign operations	-	-	(7,417)	-	-	(7,417)
Net income recognised directly in equity	-	-	(7,417)	-	-	(7,417)
Loss for the period	-	-	-	(5,986,510)	-	(5,986,510)
Total recognised income for the year	-	-	-	(5,986,510)	-	(5,968,510)
Issue of shares	110,727	5,354,169	-	-	-	5,464,896
Issue costs	-	(146,346)	-	-	-	(146,346)
At 31 December 2005	<b>893,227</b>	<b>15,325,306</b>	<b>(3,862)</b>	<b>(5,993,374)</b>	<b>1,913,889</b>	<b>12,135,186</b>
Recognition of share-based payment	-	-	-	-	226,163	226,163
Exchange differences on translation of foreign operations	-	-	(181,154)	-	-	(181,154)
Net income recognised directly on equity	-	-	(181,154)	-	-	(181,154)
Loss for the period	-	-	-	(2,812,884)	-	(2,812,884)
	-	-	-	(2,812,884)	-	(2,812,884)
Issue of shares	30,000	1,650,000	-	-	-	1,680,000
Issue costs	-	(84,000)	-	-	-	(84,000)
At 31 December 2006	<b>923,227</b>	<b>16,891,306</b>	<b>(185,016)</b>	<b>(8,877,258)</b>	<b>2,140,052</b>	<b>10,963,311</b>

The accompanying accounting policies and notes form an integral part of these financial statements.

# **HYDRODEC GROUP PLC**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the year ended 31 DECEMBER 2006

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### **1 ACCOUNTING POLICIES**

#### **BASIS OF PREPARATION**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU under the historical cost convention. They are presented in sterling, which is the functional currency of the group because the significant events of the current and prior period occurred in sterling.

The preparation of financial statements in accordance with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

#### **BASIS OF CONSOLIDATION**

The group financial statements consolidate those of the company and its subsidiary undertakings drawn up to 31 December 2006. The results of any subsidiary undertakings acquired during the period, where applicable are included from the date of acquisition.

#### **GOODWILL**

Goodwill on consolidation, representing the excess of the fair value of the consideration paid over the fair value of the identifiable net assets of subsidiary undertakings at the date of acquisition. Goodwill is initially recognised as an asset at its fair value and is subsequently measured less any accumulated impairment losses.

#### **TRADE AND OTHER RECEIVABLES**

Trade receivables, which generally have 30-90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

#### **INTEREST-BEARING LOANS AND BORROWINGS**

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings, are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

#### **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents comprise cash in hand and demand deposits that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### FINANCIAL LIABILITIES AND EQUITY

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

### INTEREST BEARING BORROWINGS

Interest-bearing bank overdrafts are measured at fair value. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings.

### FOREIGN CURRENCY TRANSLATION

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All differences are taken to the income statement with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in a foreign entity. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the income statement. Tax charges and credit attributable to exchange differences on those borrowings are also dealt with in equity.

The assets and liabilities of overseas subsidiaries are translated at the rate of exchange ruling at the balance sheet date. The income statements of overseas subsidiaries are translated at weighted average exchange rates for the year. The exchange differences arising on the retranslation are taken directly to equity. On disposal of a foreign entity, accumulated exchange differences are recognised in the income statement as a component of the gain or loss on disposal.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the acquiring company and are recorded at the exchange rate at the date of the transaction.

### REVENUE RECOGNITION

Revenues are recognised at fair value of the consideration receivable net of the amount of value added taxes.

#### **Sale of goods**

Sales revenue comprises revenue earned (net of returns, discounts and allowances) from the provision of products to entities outside the consolidated entity. Sales revenue is recognised when control of goods passes to the customer, which is normally upon delivery.

#### **Rendering of services**

Revenue from rendering services is recognised in the period in which the service is provided.

#### **Interest income**

Interest income is brought to account as it accrues.

# **HYDRODEC GROUP PLC**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the year ended 31 DECEMBER 2006

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### **Other income**

Other income is brought to account when the consolidated entity's right to receive is established and the amount can be reliably measured.

### **SHARE BASED PAYMENTS**

The Group issues equity-settled share-based payments to certain employees. Equity-settled and share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) 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 the shares that will eventually vest and adjusted for the effect of non market-based vesting conditions.

Fair value is measured using a Black-Scholes pricing 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 behavioral considerations.

### **PATENTS AND TRADEMARKS**

All costs incurred in establishing and or maintaining patents and trademarks are expensed in the period in which they are incurred.

### **PROPERTY PLANT AND EQUIPMENT**

Property, plant and equipment is measured at cost less accumulated depreciation.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, and any other costs directly attributable to bringing the asset to a working condition for its intended use.

When parts of an item of property plant and equipment have different useful lives, they are accounted for as separate items (major components) of property plant and equipment.

The cost of replacing part of an item of property plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The cost of the day-to-day servicing of property, plant and equipment are recognised as an expense as incurred.

Depreciation is provided at rates calculated to write off the cost of fixed assets, less their estimated residual value, over the expected useful lives on a straight line basis. The rates used vary between 5% and 20% per annum.

**INTANGIBLE ASSETS**

Intangible assets acquired separately from a business are capitalised at cost. Intangible assets acquired as part of an acquisition of a business are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets, excluding development costs, created within the business are not capitalised and expenditure is charged against profits in the year in which it is incurred.

The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Intangible assets, other than goodwill, are amortised over their estimated useful economic life.

**IMPAIRMENT OF TANGIBLE AND INTANGIBLE FIXED ASSETS EXCLUDING GOODWILL**

At each balance date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant assets are carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**INVENTORIES**

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of selling expenses.

The cost of inventories is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing locations and condition.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### LEASING

#### Leased assets

Leases under which the consolidated entity assumes substantially all the risks and benefits of ownership are classified as finance leases. Other leases are classified as operating leases.

#### Finance leases

A lease asset and a lease liability equal to the present value of the minimum lease payments are recorded at the inception of the lease.

Lease liabilities are reduced by repayments of principal. The interest components of the lease payments are expensed on a basis as to achieve a constant rate of interest on the remaining balance of the liability. Contingent rentals are expensed as incurred.

#### Operating leases

Payments made under operating leases are expensed on a straight line basis over the period of the lease.

### TAXATION

Income tax expense represents the sum of the current tax and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in transactions that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates enacted at the balance sheet dates and that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### KEY JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES

In the process of applying the entity's accounting policies, which are described in note 1, management has not been required to make any judgements that have a significant effect on the amounts recognised in the financial statements (apart from those involving estimations, which are dealt with below).

### KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

#### Amortisation of Intangible Assets

The intangible assets carried forward relates to intellectual property acquired by the group in 2004. The original cost of £7,866,033 will be amortised over the estimated useful life of the asset. The intellectual property consists of know how and trade secrets relating to the technology, some of which is covered in a patent. It is management's view that the useful life of the intellectual property will extend far beyond the life of the patent (approximately 10 years) and for the purposes of calculating the period over which the costs will be amortised it has been estimated that the cost will be amortised over 15 years. The carrying amount of the intangibles at the balance sheet date was £6,817,203 after the amortisation cost of £524,400 was recognized during 2006.

#### Impairment of Goodwill

Goodwill relates to the acquisition of Oil Treatment Services Pty Limited. In 2005, the directors believed that it was appropriate to recognise an impairment loss to the extent of the goodwill acquired. This situation remains unchanged in the current year, and remains under review, but is an area where judgment has been exercised.

## 2 REVENUE AND OPERATING LOSS

Revenue is wholly attributable to the Group's sole activity - the development and exploitation of the application of geochemical processes within the environment protection industry. All revenue is generated in Australia.

All profits, losses and net assets in the year to 31 December 2006 and 2005 were attributable to the development and exploitation of the application of geochemical processes within the environment protection industry, which are deemed to be continuing activities.

The loss on ordinary activities before taxation is stated after charging the following expenses, which are all included in administrative expenses:

	2006	2005
	£	£
Fees payable to the company's auditors for the audit of the group accounts	25,000	15,000
Fees payable to the company's auditor and its associates for other services:		
- the audit of the company's subsidiaries	4,030	-
- tax services	5,500	6,000
Depreciation	220,295	84,189
Amortisation of intangible assets	524,400	524,400
Cost of goods sold	411,818	173,183
Share-based payments	226,163	1,913,889
Foreign exchange loss	29,278	22,038

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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Fees paid to the group auditors and its associates for non-audit services to the company itself are not disclosed in the individual accounts of HydroDec Group plc because the company's consolidated financial statements are required to disclose such fees on a consolidated basis.

### 3 NON-RECURRING ITEMS

	2006 £	2005 £
The non-recurring items are made up of the following costs:		
- Redundancy payments - cash	-	198,707
- share based payment	-	950,754
- Write off of goodwill on acquisition of Oil Treatment Services Pty Ltd	-	2,002,777
	<u>-</u>	<u>3,152,238</u>

### 4 DIRECTORS AND EMPLOYEES

The average number of persons (including directors) employed by the group during the year was:

	2006 Number	2005 Number
Operations	33	28
Corporate office	5	5
	<u>38</u>	<u>33</u>

The aggregate cost of these employees was:

	2006 £	2005 £
Wages and salaries	856,958	382,384
Payroll taxes	32,460	79,500
Share based payments	226,163	1,913,889
	<u>1,115,581</u>	<u>2,375,773</u>

Directors emoluments paid during the period were:

	2006 £	2005 £
Emoluments	195,000	131,799
Benefits in kind	-	265,584
	<u>195,000</u>	<u>397,383</u>

The highest paid director received emoluments totalling £89,680 (2005: £137,175). There were no pension contributions for directors (2005: £nil).

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### 5 TAX

	2006 £	2005 £
Current tax	<u>-</u>	<u>-</u>
Loss on ordinary activities before taxation	<u>(2,586,721)</u>	<u>(5,986,510)</u>
Rate of corporation tax in the United Kingdom of 30% (2005: 30%)	<b>(776,016)</b>	(1,795,953)
Effects of:		
Expenses not deductible for tax purposes	<b>292,500</b>	1,332,320
Increase in tax losses	<u><b>483,516</b></u>	<u>463,633</u>
Current tax charge	<u>-</u>	<u>-</u>

A deferred tax asset of approximately £900,000 (2005:£465,000) is not recognised due to the uncertainty of future taxable profits.

### 6 LOSS PER SHARE

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

The weighted average number of shares used in the calculations are set out below:

2006 Number of shares	2005 Number of shares
<u><b>179,944,032</b></u>	<u>160,812,447</u>

In 2005 and 2006, the share options were anti-dilutive and consequently no diluted earnings per share figure is included.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### 7 PROPERTY, PLANT AND EQUIPMENT

	<b>Plant and equipment £</b>
<b>Cost</b>	
At 1 January 2005	293,322
Additions	1,281,307
On acquisition of subsidiary	619,040
At 31 December 2005	<u>2,193,669</u>
Change in exchange rate	(107,311)
Additions	1,883,314
Disposals	(44,845)
At 31 December 2006	<u><b>3,924,827</b></u>
<b>Accumulated depreciation</b>	
At 1 January 2006	-
Depreciation charge for the year	84,189
At 31 December 2005	<u><b>84,189</b></u>
Depreciation charge for the year	220,295
At 31 December 2006	<u><b>304,484</b></u>
<b>Carrying amount</b>	
At 31 December 2006	<u><b>3,620,343</b></u>
At 31 December 2005	<u>2,109,480</u>

Plant and equipment is depreciated at various rates depending on the estimated life of the item of plant. The rates of depreciation vary between 5% and 20% per annum.

The carrying amount of the group's plant and equipment includes £225,316 (2005: £20,058) in respect of assets held under finance leases.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

### 8 INTANGIBLE FIXED ASSETS

	<b>Hydrodec Technology</b>	<b>Goodwill</b>	<b>Total</b>
	<b>£</b>	<b>£</b>	<b>£</b>
At 1 January 2005	7,866,033	-	7,866,003
Additions	-	2,002,777	2,002,777
At 31 December 2005	7,866,003	2,002,777	9,868,780
Additions	-	-	-
At 31 December 2006	<b>7,866,003</b>	<b>2,002,777</b>	<b>9,868,780</b>
<b>Accumulated amortisation</b>			
At 1 January 2005	-	-	-
Amortisation charge for the year	524,400	-	524,400
Impairment	-	2,002,777	2,002,777
At 31 December 2005	524,400	2,002,777	2,527,177
Amortisation charge for the year	524,400	-	524,400
At 31 December 2006	<b>1,048,800</b>	<b>2,002,777</b>	<b>3,051,577</b>
<b>Carrying amount</b>			
At 31 December 2006	<b>6,817,203</b>	-	<b>6,817,203</b>
At 31 December 2005	7,341,603	-	7,341,603

The Hydrodec Technology is being amortised over its anticipated useful life of 15 years. The intangible asset carried forward relates to intellectual property acquired by the group in 2004. The intellectual property consists of know how and trade secrets relating to the Technology, some of which is covered in a patent. It is management's view that the useful life of the intellectual property will extend far beyond the life of the patent (approximately 10 years) and for the purposes of calculating the period over which the costs will be amortised it has been estimated that the minimum useful life of the Technology is 15 years. At 31 December 2006 the unamortised life of the asset was 13 years.

Goodwill relates to the acquisition of Oil Treatment Services Pty Limited. In 2005, the directors believed that it was appropriate to recognise an impairment loss to the extent of the goodwill acquired. This situation will be closely monitored, and adjustments may be considered in future periods if such adjustments are appropriate. The directors acquired the company to provide a platform for creating a centre of excellence based in Young, Australia and not for its historic activities.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

### 9 TRADE AND OTHER RECEIVABLES

	2006 £	2005 £
Trade receivables	96,454	149,378
Other receivables	33,061	5,029
Other taxation and social security	55,097	45,723
Prepayments and accrued income	-	3,582
	<u>184,612</u>	<u>203,712</u>

### 10 INVENTORY

	2006 £	2005 £
Finished goods at cost	<u>75,361</u>	<u>54,434</u>

### 11 CURRENT LIABILITIES

	2006 £	2005 £
Bank overdraft	54,025	99,283
Trade payables	57,275	209,363
Finance lease obligations	111,090	146,583
Other taxation and social security	35,162	34,398
Accruals and deferred income	161,288	190,531
	<u>418,840</u>	<u>680,158</u>

### 12 SHARE CAPITAL

	2006 £	2005 £
Authorised 800,000,000 ordinary shares of 0.5 pence each	<u>4,000,000</u>	<u>4,000,000</u>
Issued and fully paid - ordinary shares of 0.5 pence each	£	£
At the beginning of the year	893,227	782,500
Issued for cash	<u>30,000</u>	<u>110,727</u>
At the end of the year	<u>923,227</u>	<u>893,227</u>

The company issued the following 0.5 pence ordinary shares during the period:

Date of issue	Number of shares	Issue price	Total consideration £
13 October 2006	6,000,000	28 pence	1,680,000

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### 13 RESERVES

The share premium account represents the excess over the nominal value for shares allotted.

The foreign exchange reserve records differences arising from the re-transaction of the net investment in subsidiaries and the net difference of translation of amounts used to fund the acquisition of foreign assets and the translation of such assets.

The share option reserve represents accumulated charges made under IFRS 2 in respect of share based payments.

### 14 SHARE BASED PAYMENTS

#### Equity-settled share option scheme

The Company has a share option scheme for selected employees and directors of the Group. Options are exercisable at a price equal to the average quoted market price of the Company's shares on the date of grant. The vesting period is over a variable period up to 10 years. No options were forfeited or exercised in the year and no options were exercisable at 31 December 2006.

	Number	Weighted average exercise price
Outstanding at the beginning of the year	14,600,000	15.7p
Issued in the year	<u>3,000,000</u>	26.3p
<b>Outstanding at the end of the year</b>	<b><u>17,600,000</u></b>	<b>17.6p</b>

These fair values were calculated using a Black-Scholes option pricing model as follows:

	2006	2005
Weighted average share price	<b>21.1p</b>	20.1p
Weighted average exercise price	<b>17.6p</b>	15.7p
Expected volatility	<b>95%</b>	103%
Expected life	<b>10.0yrs</b>	9.5 yrs
Risk free rate	<b>5%</b>	5%
Expected dividend yield	<b><u>0.4%</u></b>	<u>0%</u>

Expected volatility was assessed based on the volatility of the company's shares since incorporation.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### 15 FINANCIAL INSTRUMENTS

#### Financial Risk

The group's financial instruments comprise cash and liquid resources, and various items, such as trade debtors and trade creditors that arise directly from its operations. No trading in financial instruments is undertaken.

The main risks arising from the group's financial instruments are interest rate and liquidity. The Board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained unchanged during the year.

#### Liquidity risk

The group seeks to manage financial risk by ensuring sufficient liquidity is available to meet foreseeable needs and to invest cash assets safely and profitably.

#### Interest rate risk

The group finances its operations through equity group funds which are invested in deposit accounts with the objective of maintaining a balance between accessibility of funds and competitive rates of return. The weighted average interest rate received on deposited funds was 4% during the year.

#### Credit risk

The group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment. The maximum exposure to credit risk for the group is £96,454 (2005: £149,378).

The credit risk on liquid funds is limited because the counterparties are reputable international banks.

#### Currency risk

Transactions and balances of the subsidiaries are denominated in the local currency and had the following balances denominated in Australian dollars:

	2006 £	2005 £
Inventory	75,361	-
Trade and other receivables	167,429	192,939
Cash and cash equivalents	34,343	2,101
Borrowings	(54,025)	(168,152)
Trade and other payables	<u>(289,856)</u>	<u>(182,402)</u>

The Group keeps under review the extent of its exposure to currency fluctuations.

#### Fair values

The directors consider there to be no material difference between the book value and fair value of the group's financial instruments in either financial year.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2006

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### 16 CAPITAL COMMITMENTS

The company at 31 December 2006 has commenced planning for the construction of two production plants in the USA, each with an expected operating capacity of approximately 20,000 litres per day. The maximum amount of capital expected to be committed to the projects at balance date was approximately £10 million, although no firm commitments or contracts have been entered into.

Other than listed above, the company had no capital commitments at 31 December 2006 or 31 December 2005.

### 17 CONTINGENT LIABILITIES

There were no contingent liabilities at 31 December 2006 or 31 December 2005.

### 18 RELATED PARTY TRANSACTIONS

Services from Virotec, a substantial shareholder of the group, to the value of £30,724 were received during the year ended (2005: £30,039). Amounts due to Virotec International Limited at 31 December 2006 were £ nil (2005: £9,300).

AirTerAq, a company in which a director, M D McNamara has an interest, supplied services to the value of £86,680 during 2006 (2005: £26,664) and was owed £nil at 31 December 2006 (2005: £nil).

## **REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF HYDRODEC GROUP PLC**

We have audited the parent company financial statements of Hydrodec Group PLC for the year ended 31 December 2006 which comprise the principal accounting policies, the balance sheet and notes 1 to 24. These parent company financial statements have been prepared under the accounting policies set out therein. We have reported separately on the group financial statements of Hydrodec Group PLC for the year ended 31 December 2006.

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' responsibilities for preparing the Annual Report, and the parent company financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view, whether the parent company financial statements we also report to you have been properly prepared in accordance with the Companies Act 1985 whether in our opinion the information given in the Directors' Report is consistent with the financial statements. In addition we also report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Corporate Governance Statement, Directors' Report and the Chairman's Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

## **REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF HYDRODEC GROUP PLC**

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company 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 parent company financial statements 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 parent company financial statements.

### **Opinion**

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006; and
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

**GRANT THORNTON UK LLP  
REGISTERED AUDITORS  
CHARTERED ACCOUNTANTS**

**LONDON  
8 MARCH 2007**

Note: The maintenance and integrity of the Hydrodec Group PLC website is the responsibility of the directors: the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

# HYDRODEC GROUP PLC

## COMPANY BALANCE SHEET AT 31 DECEMBER 2006

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	Note	2006 £	2005 £
<b>Fixed assets</b>			
Investments	21	<u>8,232,146</u>	<u>8,232,146</u>
<b>Current assets</b>			
Trade and other receivables	22	17,183	10,773
Amount due from subsidiary undertaking		7,502,490	4,076,051
Cash and cash equivalents		<u>911,595</u>	<u>3,255,607</u>
		<u>8,431,268</u>	<u>7,342,431</u>
<b>Current liabilities</b>	23	<u>(74,959)</u>	<u>(155,776)</u>
<b>Net current assets</b>		<u>8,356,309</u>	<u>7,186,655</u>
<b>Total assets less current liabilities</b>		<u>16,588,455</u>	<u>15,418,801</u>
<b>Capital and reserves</b>			
Called up share capital	12	923,227	893,227
Share premium account		16,891,306	15,325,306
Profit and loss account	0	<u>(1,226,078)</u>	<u>(799,732)</u>
<b>Shareholders' funds</b>		<u>16,588,455</u>	<u>15,418,801</u>

The financial statements were approved by the Board of Directors on 8 March 2007 and were signed on its behalf by:

**R D Sargent - Director**

The accompanying accounting policies and notes form an integral part of these financial statements.

# HYDRODEC GROUP PLC

## NOTE TO COMPANY BALANCE SHEET AT 31 DECEMBER 2006

### 19 SIGNIFICANT ACCOUNTING POLICIES

The separate financial statements of the company are presented as required by the Companies Act 1985. As permitted by that Act, the separate financial statements have been prepared in accordance with all applicable United Kingdom accounting standards. The principal accounting policies which differ to those set out in the principal accounting policies to the consolidated financial statements are set out below.

The financial statements have been prepared on the historical cost basis.

Investments in subsidiaries are recorded at cost, less amount written off.

Deferred tax is recognised on all timing differences where the transactions or events that give the Group an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred by the balance sheet date. Deferred tax assets are recognised when it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the balance sheet date.

### 20 DIRECTORS AND EMPLOYEES

The average number of persons (including directors) employed by the company during the year was:

	2006 Number	2005 Number
Operations	-	-
Corporate office	5	5
	<u>5</u>	<u>5</u>

The aggregate cost of these employees was:

	2006 £	2005 £
Wages and salaries	195,000	283,008
Payroll taxes	-	36,225
Share based payments	226,163	1,913,889
	<u>421,163</u>	<u>2,233,122</u>

Directors emoluments paid during the period were:

	2006 £	2005 £
Emoluments	195,000	131,799
Benefits in kind	-	265,584
	<u>195,000</u>	<u>397,383</u>

The highest paid director received emoluments totalling £89,680 (2005: £137,175). There were no pension contributions for directors (2005: £nil).

# HYDRODEC GROUP PLC

## NOTE TO COMPANY BALANCE SHEET AT 31 DECEMBER 2006

### 21 INVESTMENTS

	Shares in subsidiary undertakings £	Loans to subsidiary undertakings £	Total £
Cost			
At 1 January 2006	7,621,124	611,022	8,232,146
Additions	-	-	-
At 31 December 2006	<u>7,621,124</u>	<u>611,022</u>	<u>8,232,146</u>

The subsidiary undertaking at 31 December 2006 is listed below:

	Country of incorporation and principal operations	Ordinary share capital held	Activity
HydroDec Development Corporation Pty Limited	Australia	100%	Technology and Holding Company
HydroDec Australia Pty Limited*	Australia	100%	Oil Treatment Services

\* Held through HydroDec Development Corporation Pty Limited.

### 22 TRADE AND OTHER RECEIVABLES

	2006 £	2005 £
Other receivables	<u>17,183</u>	<u>10,773</u>

### 23 CURRENT LIABILITIES

	2006 £	2005 £
Accruals and deferred income	<u>74,959</u>	<u>155,776</u>
	<u>74,959</u>	<u>155,776</u>

### 24 PROFIT AND LOSS ACCOUNT

	£
At 1 January 2006	(799,732)
Loss for the financial year	(426,346)
At 31 December 2006	<u>(1,226,078)</u>

The company has taken advantage of the exemption allowed under section 230 of the Companies Act 1985 and has not presented its own profit and loss account in these financial statements. The loss for the year, in the financial statements of the company was a loss of £426,346 (2005: £792,868).

# HYDRODEC GROUP PLC

## COMPANY TRADING AND PROFIT AND LOSS ACCOUNT

For the year ended 31 DECEMBER 2006

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	2006 £	2005 £
Turnover	-	-
Cost of sales	-	-
Gross profit	-	-
Administrative expenses	<u>(480,755)</u>	<u>(880,315)</u>
<b>Operating loss</b>	<b>(480,755)</b>	<b>(880,315)</b>
Interest receivable	<u>54,409</u>	<u>87,447</u>
<b>Loss on ordinary activities before taxation</b>	<b>(426,346)</b>	<b>(792,868)</b>
Tax on profit on ordinary activities	<u>-</u>	<u>-</u>
<b>Loss for the period</b>	<b><u>(426,346)</u></b>	<b><u>(792,868)</u></b>

**THIS PAGE DOES NOT FORM PART OF THE AUDITED FINANCIAL STATEMENTS**