



HYDRODEC GROUP PLC

ANNUAL REPORT AND ACCOUNTS 2009

HYDRODEC GROUP PLC

DIRECTORS, SECRETARY AND ADVISERS

Company registration number:	5188355
Registered office:	4th Floor 120 Moorgate London EC2M 6SS
Directors:	R N Gaskell (Non-executive chairman) J H Gunn (Non-executive deputy chairman) G M Leates (Non-executive director) M D McNamara (Chief executive officer) J G Cowan (Executive director, Business Development)
Company secretary:	M Preen
Nominated adviser and broker:	Numis Securities Ltd The London Stock Exchange Building 10 Paternoster Square London EC4M 7LT
Bankers:	JP Morgan Chase
Solicitors:	Norton Rose 3 More London Riverside London SE1 2AQ
Registrars:	Capita Registrars Northern House Woodsome Park Fenay Bridge Huddersfield HD8 0GA
Auditor:	Grant Thornton UK LLP Registered Auditor Chartered Accountants Grant Thornton House Melton Street Euston Square London NW1 2EP

HYDRODEC GROUP PLC

CONTENTS

INDEX	PAGE
Chairman's statement	2
Chief Executive's report	3 – 5
Report of the Directors	6 – 8
Corporate governance statement	9 – 13
Independent auditor's report	14 – 15
Consolidated statement of comprehensive income	16
Consolidated statement of financial position	17
Consolidated statement of cash flows	18
Consolidated statement of changes in equity	19
Notes to the financial statements	20 – 40
Independent auditor's report	41 – 42
Company balance sheet	43
Notes to the Company balance sheet	44 – 49
Notice of Annual General Meeting	50 – 54

HYDRODEC GROUP PLC

CHAIRMAN'S STATEMENT

2009 was a challenging year but the Company made significant progress against a difficult economic backdrop, ending the year with its two plants running well, major new customers in the US and improved throughput in both the US and Australia. Challenges included some of the worst trading conditions for many decades in the US, steep oil price declines at the start of the year, global recession and equipment related operational problems at Canton. The global recession reversed the previous tight supply conditions for transformer oils and the subsequent oversupply created an immediate drop in prices at the start of the year that carried through the entire year. Average gross margins fell from around US 70 cents per litre in 2008 to below US 20 cents per litre by the end of the year driven by global market conditions beyond the control of the Company. These unprecedented events resulted in the Company making a further loss in the second half of the year on lower volumes than planned.

However, based on the steady economic recovery underway in the US, there are now signs of increasing demand and feedstock supply, and during the first quarter of 2010 margins had already improved by around US 7 cents per litre from their low point at the start of the 2010 and this trend has continued in April. The Board and Management believe the Company is well positioned to take advantage of this recovery and look forward to further progress in 2010.

The Board was reinforced with a number of changes during the year including the appointment of Gill Leates as a new non-executive Director. Since the period end we have also strengthened the executive management team with the appointment of Paul Manchester as Chief Financial Officer and Stephen Harker as Chief Operating Officer.

I am confident that the business will continue to grow stronger as we develop further both our existing business and our exciting plans for growth with the recently announced Japanese strategic alliance. Hydrodec's potential global market opportunity to treat polychlorinated biphenyl ("PCB") contaminated transformer oil is huge and likely to be driven by increasing regulatory pressure. PCBs are a highly toxic substance that were extensively used as an additive in transformer oils and are still widely present globally, either stockpiled by users or still in circulation within transformers built many years ago.

The results for the year have been reported in US dollars, compared with previous reporting in Sterling. The Board has taken the view that the presentational currency for the Group should be US dollars reflecting not only the importance of the US operations to the Group but also that the US dollar is the currency most widely used around the world in oil pricing. The comparative information has been restated to reflect US dollar values.

Finally, I would draw your attention to the Notice of Annual General Meeting at the back of these Reports and Accounts. This year's AGM will be held at the offices of Numis Securities at 10.00am on Thursday 27 May 2010.



Neil Gaskell
Chairman

27 April 2010

HYDRODEC GROUP PLC

CHIEF EXECUTIVE'S REPORT

2009 was a year of substantial achievement for Hydrodec in firmly establishing itself as an innovative provider of cleantech solutions to the world's transformer oil markets. Yet these achievements were overshadowed by a tough global economic environment and poor industry fundamentals, resulting in a continued loss for the period.

The Group's technology is a proven oil refining and recycling process which is currently being targeted at the multi-billion US\$ market for transformer oil, primarily used by the world's electricity industry. The Group takes spent oil, including PCB-contaminated oil (currently only in Australia), as the primary feedstock, which is then processed at its two plants enabling 99% or greater recovery of oil for reuse while also eliminating PCBs without environmentally harmful emissions.

Demand for the Company's SUPERfine branded transformer oil continued to grow during the year as the environmental and economic benefits of our process and technically premium product gained wider acceptance.

Turnover for the year increased by 49 per cent. to US\$10.4 million (2008: US\$7.0 million), reflecting higher refinery output from the first full year of operations at our US plant in Canton, Ohio. Increased sales volumes were, however, offset by the lower market prices for transformer oil which fell from an average of just over US\$1.25 per litre in 2008 to US 79 cents per litre in 2009. 2009 revenue benefited from US\$1.0m in loss of profits insurance proceeds relating to equipment failure which caused temporary capacity reduction at the Canton plant, and which has since been addressed.

The strong ramp up in sales volumes was more than offset by reduced margins resulting in an overall operating loss of US\$11.5 million (2008: US\$9.4 million).

Operating review

The Company commenced 2009 having successfully commissioned its first US plant in Canton, Ohio and having a second US plant in Laurel, Mississippi at an advanced stage of planning. 2009 provided an extremely difficult economic and market backdrop for the Company to operate against. The first weeks of 2009 saw the global financial crisis cause a sharp drop in demand for transformer oil resulting in an immediate and sharp drop in prices and volumes. 2009 base oil refining margins in the US were in real terms at multi-decade lows across the board indicating significant general oversupply in the market which has continued into 2010.

We also noticed a reduction in feedstock availability in the US which also continued into 2010 and which may relate to increased diversion of used oil into the home heating oil market during the winter, combined with decreased utility maintenance rates linked to the heavy winter and tightened maintenance budgets during the recession.

The Company's success in converting new customers to a new product in this environment is a testament to the quality of our SUPERfine product and the competitiveness of our business model. The Company achieved increased sales to, and expanded its direct relationship with, major customers including US utilities and original equipment manufacturers ("OEMs"). We also secured new export customers in Colombia, Brazil, Peru and the Dominican Republic. Additionally, the technical approval process for the Company's product is ongoing with further new customers in the US including SUPERfine transformer oil in their approved products list. As a result Group sales volumes for the year were 11.80 million litres, compared with 3.85 million litres in 2008, of which about 8 million litres were delivered in second half sales. The goal is progressively to widen and deepen the portfolio of customers so that earnings are both increased and diversified.

Following the resolution of the heater problems at Canton, both plants ended the year with reliable production and potential sales in Australia and Canton were not production constrained.

The Company operates complex industrial plants involving hazardous conditions, substances and materials. As a consequence we place great emphasis on our environmental performance and the safety of our employees and our broader communities. During 2009 we maintained our exemplary safety and environmental performance with a world class All Injury Frequency Rate (AIFR) of 0.644 and no reportable environmental incidents. We are very proud of our world class safety and environmental performance and strive continuously to further improve in these areas.

HYDRODEC GROUP PLC

CHIEF EXECUTIVE'S REPORT

Multiple environmental approvals

During the year the smaller demonstration plant attached to the Young facility in New South Wales, Australia was granted an Environmental Protection Agency licence to destroy PCB contaminated material with a concentration of up to 5,000 parts per million. This licence was granted with no requirement to monitor air emissions. We believe this is the first high level PCB destruction process to be granted a licence based upon nil emissions.

In the US, the Group expects final approval from the Federal Environmental Protection Agency to treat PCB-contaminated transformer oil at the Canton plant to be granted in the second half of 2010, having successfully completed demonstration trials at the Canton plant.

Of potentially far greater significance still is the approval by the Japanese Ministry of Environment of Hydrodec's recycling process, obtained shortly after the year end. It is the only treatment approved and authorised in Japan that recovers in excess of 99% of used transformer oil while removing PCBs, a toxic substance banned under international and Japanese laws. Based on industry data the current estimated volume of PCB-contaminated transformer oil processing demanded by the technology approval granted in Japan is in excess of 1 billion litres, or US\$1 billion in potential revenues.

Strategic alliance in Japan/Asia

Following two years of negotiations, in March 2010 the Company announced it had reached a strategic alliance agreement with Kobelco Eco-Solutions ("KES"), a unit of the Kobe Steel Group, for an exclusive 50/50 joint venture to commercially exploit all Hydrodec technology applications and operations in a region covering Japan, South Korea, Taiwan, China, India and Vietnam.

The alliance with KES combines the unique Hydrodec technology with a respected multinational engineering group with a major operational presence in Japan and the East Asia market place. The Board believes this is a transformational deal that provides the platform for accelerated growth of Hydrodec in the transformer oil and PCB treatment markets and accelerated entry into other projects and markets outside transformer oils especially in Japan.

The agreement provides for construction of the first plant in Japan by 2012 and Hydrodec's share of development, construction and working capital costs are to be financed by debt secured on the joint venture projects.

Disposals

During the first half of the year the Company also disposed of its transformer oil condition monitoring business for AUD 0.8 million and the Molecetra shares, which were acquired as part of the Virotec acquisition, for £0.3 million. These disposals produced cash without affecting the core business of the Group and neither had a material effect on the Group's results or financial position for the period.

Fundraisings

During the year the Company raised approximately £7.25m (gross) through the issue of, in aggregate, approximately 62 million new ordinary shares in placings carried out in February, June and December. Since the year end the Company has raised an additional £2m (gross) through the issue of approximately 20 million new ordinary shares in a placing in March 2010.

Board and management changes

The composition of the Board of the Company changed during the year with the appointment in June 2009 of Neil Gaskell as the new non-executive Chairman, John Gunn as non-executive Deputy Chairman and Gill Leates as a new non-executive Director. Rodger Sargent resigned as a non-executive Director with effect from July 2009 and John Dickson resigned as Finance Director with effect from December 2009.

Since the year end the Board and I have been very pleased to welcome Paul Manchester (Chief Financial Officer) and Stephen Harker (Chief Operating Officer) to the management team. Their respective strengths and experience will prove of great value to the Company.

HYDRODEC GROUP PLC

CHIEF EXECUTIVE'S REPORT

Outlook

The US base oil industry is reporting a pick-up in demand and a move towards a more balanced supply and demand position. More specifically transformer oil appears to have entered an upward price trend, away from the late 2009 and early 2010 historic lows, for the first time since late 2008. We look forward to ongoing improvement in trading conditions through which we can progressively rebuild our resources and continue to develop our portfolio of customers and suppliers so that the Company can deliver the robust returns of which it should be capable.

Mark McNamara
Chief Executive Officer

27 April 2010

HYDRODEC GROUP PLC

REPORT OF THE DIRECTORS

The Directors present their report together with the audited financial statements for the year ended 31 December 2009.

Principal activity, business review and business risks

The Group's principal activity is the commercialisation of the Hydrodec technology which is a patented technology for the re-refining of used transformer oil into new SUPERfine™ transformer oil.

The review of the business is included in the Chairman's Statement and Chief Executive's Report (which, together with the Corporate Governance Statement, are incorporated by reference into this Report of the Directors).

The key business risk associated with the business is maintaining sufficient operating cash flow to fund financing and necessary capital expenditure. Further details of business risks are set out in the Chairman's Statement and Chief Executive's Report.

Results and dividends

The consolidated statement of comprehensive income for the year is set out on page 16. No dividend has been declared or is proposed for the period. The financial statements have been prepared on a going concern basis as described in note 1.

Directors

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

	31 December 2009		31 December 2008	
	Ordinary shares of 0.5p each	Share options of 0.5p each	Ordinary shares of 0.5p each	Share options of 0.5p each
	Number	Number	Number	Number
J H Gunn	4,637,500	3,000,000	4,637,500	3,000,000
M D McNamara	166,667	6,500,000	–	6,500,000
J G Cowan	–	2,100,000	–	2,100,000
G M Leates (appointed 12 June 2009)	120,000	500,000	n/a	n/a
R N Gaskell (appointed 18 June 2009)	120,000	2,200,000	n/a	n/a
R D Sargent (resigned 28 July 2009)	n/a	n/a	1,000,000	1,000,000
J W Dickson (resigned 14 December 2009)	n/a	n/a	–	1,000,000

At the end of the year J H Gunn and R N Gaskell had an interest in £100,000 (2008: £100,000) and £50,000 (2008: n/a) respectively of the Company's convertible loan notes, as described further in note 14 to the financial statements.

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

	Share options	Exercise price (pence)	Earliest exercise date	Latest exercise date
J H Gunn	2,000,000	11.50p	29 April 2007	29 April 2015
J H Gunn	1,000,000	33.25p	24 Jan 2010	24 Jan 2018
M D McNamara	5,000,000	11.50p	15 July 2005	29 April 2015
M D McNamara	1,500,000	33.25p	24 Jan 2010	24 Jan 2018
J G Cowan	1,100,000	24.50p	1 Jan 2007	18 Jan 2016
J G Cowan	1,000,000	18.75p	1 Jan 2008	20 Sep 2017
G M Leates	500,000	15.00p	n/a	16 Jul 2019
R N Gaskell	2,200,000	15.00p	n/a	16 Jul 2019

HYDRODEC GROUP PLC

REPORT OF THE DIRECTORS

Options issued to G M Leates and R N Gaskell are only exercisable on the attainment of pre-determined share price targets.

The share price was 27p on 1 January 2009 and 13.25p on 31 December 2009, with a high and low during the year of 33.25p and 8.35p 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 concerning the payment of suppliers is to settle terms of payment when agreeing the terms of the transactions and to abide by the agreed terms. The holding company's creditor days at 31 December 2009 was 41 days (2008: 60 days).

Financial risk management objectives and policies

The Group's financial instruments comprise cash, liquid resources and a convertible loan, and various items, such as trade receivables and trade payables that arise directly from its operations. The main risks arising from the Group'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 in note 19 to the financial statements. These policies have remained unchanged from previous years.

Directors' indemnity and insurance

The Company has granted an indemnity to its Directors and officers under which the Company will indemnify them, subject to the terms of the deed of indemnity, against all costs, charges, losses and liabilities incurred by them in the performance of their duties.

The Company arranged directors' and officers' liability insurance at a cost of US\$58,000 in 2009 (2008 – nil).

Related party transactions

In addition to the related party transactions disclosed in note 23 to the financial statements, and as required by the AIM Rules, the Directors report that during the year Aviva plc (and its subsidiaries), being a holder of more than 10 per cent. of the Company's voting share capital, subscribed for the following number of shares in the Company's placings:

- February 2009 3.3m shares for total consideration of £330,000
- June 2009 3.75m shares for total consideration of £525,000
- December 2009 2.1m shares for total consideration of £250,000

Statement of Directors' responsibilities

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs) and elected to prepare parent company financial statements in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). The financial statements are required by law to give a true and fair view of the state of affairs of the Group and parent company and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable IFRSs have been followed, subject to any material departures disclosed and explained in the financial statements; and

HYDRODEC GROUP PLC

REPORT OF THE DIRECTORS

- 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.

The Directors are responsible for keeping adequate 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 2006. 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 the section 489 of the Companies Act 2006.

BY ORDER OF THE BOARD

Neil Gaskell
Chairman
27 April 2010

Company registration no: 5188355

HYDRODEC GROUP PLC

CORPORATE GOVERNANCE STATEMENT

The Board

During the year the composition of the Board was changed with the appointment of Neil Gaskell (non-executive Chairman) and Gillian Leates (non-executive Director), and the resignation of Rodger Sargent (non-executive Director) and John Dickson (Finance Director). The composition of the Board's audit and remuneration committees was also changed, and a new nominations committee was established, with new terms of reference for each committee being adopted, as described further below.

Brief biographical details for the current Board members are set out below:

Neil Gaskell (Non-executive Chairman)

Neil has 25 years of experience of senior management roles in various companies in the Shell Group including working in Japan as Representative Director and Deputy Chief Executive of Showa Shell Sekiyu KK. From 2000 to 2003, he was Shell Group Treasurer, responsible for all financing policies, funding and financial risk management and a director of Shell International Limited. He is currently a non-executive director of several companies including Wellstream Group Plc and Chairman of Aberdeen All Asia Investment Trust PLC. He is a fellow of the Association of Chartered Certified Accountants and has a B.A. in Philosophy and Economics from the London School of Economics, of which he is also a Governor. Neil joined the Board in June 2009 and became Chairman in July of that year. He also chairs the Board's audit committee, nominations committee and remuneration committee.

John Gunn (Non-executive Deputy Chairman)

John is a director of a number of quoted and unquoted companies including Rotala plc, Capital Accumulation Limited and Healthcare Enterprises plc. He is also the founder and a director of Wengen Limited. He was formerly chief executive officer of Exco International plc and chairman of Telerate Inc and British and Commonwealth plc. John joined the Board at the time of the Company's admission to AIM in August 2004 and served as Chairman until July 2009. He also serves on the Board's audit committee, nominations committee and remuneration committee. John retires by rotation at this year's AGM and a resolution is included for his re-election.

Gillian Leates (Non-executive Director)

Gill brings with her a wealth of public market experience having served as Investment Director on the main board of Majedie Investments PLC. She also served as a non-executive director of Majedie Asset Management Limited where she played a key role in setting up the UK pension fund management business in 2002 which now manages approximately £4 billion. Gill joined the Board in June 2009 and also serves on the Board's audit committee, nominations committee and remuneration committee.

Mark McNamara (Chief Executive Officer)

Mark's experience and background are in the engineering technology and environmental services field, providing contracting, project management and technology management services. He managed the construction and subsequent commissioning of the first Hydrodec plant in Australia in 2004. Previously he was employed for ten years by the Clough Engineering group and was responsible for the formation, strategic direction and management of their environment technology and engineering subsidiary. He has a Bachelor of Applied Science (Chemistry). Mark joined the Board in December 2004 at the time of the Company's acquisition of the Hydrodec technology originally as Chief Operating Officer and assumed the role of CEO in August 2005. He also serves on the Board's nominations committee.

John Cowan (Executive Director, Business Development)

Since the early 1980's John has worked in the oil and gas, environmental science and technology business in North America and internationally in the areas of project management, compliance assessment, business development and technology development. He worked with the Hydrodec technology in its early development stages while Managing Director of Dow Chemical's environment business in the Austral-Asia region. Since

HYDRODEC GROUP PLC

CORPORATE GOVERNANCE STATEMENT

joining Hydrodec in 2006 he directed the site selection and all development work associated with the Group's start-up in the US, and was responsible for launching the SUPERfine brand and obtaining product approvals from key transformer manufacturers. He has a Bachelor of Science (Chemistry/Ecology) from the University of Washington and is a member of the Society of Petroleum Engineers. John joined the Board in September 2007.

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 management and corporate governance of the consolidated entity including its strategic direction, establishing goals for management and monitoring the achievement of these goals.

From time to time the Board may delegate or entrust to any Director holding executive office (including the CEO) such of its powers, authorities and discretions for such time and on such terms as it thinks fit. During the year the Board adopted a "Delegation of Board authority" which establishes those matters which it is considered appropriate remain within the overall control of the Board (or its committees) and those which are delegated to the CEO (or onwards as appropriate). In addition to overall Group strategy, the Board retains control over corporate activity (mergers, acquisitions, joint ventures, disposals and investments) and material contract and financing decisions (over and above set value/credit-risk limits).

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, a Remuneration Committee and a Nominations Committee and a framework for the management of the consolidated entity including a system of internal control.

The full Board hold physical meetings quarterly and physical and/or telephonic meetings 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 is ultimately responsible for the Company's system of internal control and for reviewing its effectiveness. This includes financial, operational and compliance controls and risk-management systems. The Board has reviewed the effectiveness of the system of internal control during the year. In particular, it has reviewed and updated the process for identifying and evaluating the significant risks affecting the Company and policies by which these risks are managed. Management prepares regular management reports which allow the Board to assess the Company's activities and review its performance and the Board have clearly specified the levels of authority delegated to Management. Internal control systems are designed to meet the Company's particular needs and the risks to which it is exposed. Accordingly, the internal control systems are designed to manage rather than eliminate the risk of failure to achieve business objectives and by their nature can only provide reasonable and not absolute assurance against misstatement and loss.

HYDRODEC GROUP PLC

CORPORATE GOVERNANCE STATEMENT

Composition of the Board

The composition of the Board is determined using the following principles:

- the Board currently comprises five Directors. The number of Directors 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 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 its Terms of Reference which were amended and adopted by the Board of Directors on 24 September 2009.

The purpose of the Committee is to assist the Board in the effective discharge of its responsibilities for corporate governance, financial reporting, corporate control and risk management. Its objectives are:

- to increase shareholder confidence and to ensure the credibility and objectivity of published financial information;
- to assist the Board in meeting its financial reporting responsibilities;
- to assist the Board in ensuring the effectiveness of the Company's internal accounting and financial controls;
- to strengthen the independent position of the Company's external auditors by providing channels of communication between them and the non-executive Directors; and
- to review the performance of the Company's external auditing functions.

The members of the Audit Committee for 2009 were J H Gunn (Chairman) and R D Sargent until 18 June 2009, when G M Leates and R N Gaskell (replacing J H Gunn as Chairman) joined the committee and R D Sargent retired from it.

The external auditors, the Chief Executive Officer and the Chief Financial Officer 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.

HYDRODEC GROUP PLC

CORPORATE GOVERNANCE STATEMENT

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.

The Committee's terms of reference can be accessed on the Company's website.

Remuneration Committee

The role of the Remuneration Committee is documented in its Terms of Reference which were amended and adopted by the Board of Directors on 24 September 2009.

The objectives of the Remuneration Committee are:

- to ensure that the Company's directors and senior executives are fairly rewarded for their individual contributions to the Company's overall performance by determining their pay and other remuneration; and
- to demonstrate to all shareholders that the general policy relating to and actual remuneration of individual senior executives of the Company is set by a committee of the Board members who have no personal interest in the outcome of the decisions and who will give due regard to the interests of the shareholders and to the financial and commercial health of the Company.

The members of the Remuneration Committee for 2009 were J H Gunn (Chairman) and R D Sargent until 18 June 2009, when G M Leates and R N Gaskell (replacing J H Gunn as Chairman) joined the committee and R D Sargent retired from it.

The Chief Executive Officer may be invited to Remuneration Committee meetings at the discretion of the Committee. The Committee plans to meet at least four times during the year.

The Committee's terms of reference can be accessed on the Company's website.

Nominations Committee

The Nominations Committee was established during the year and its members were R N Gaskell (Chairman), J H Gunn, G M Leates and M D McNamara. The role of the Nominations Committee is documented in its Terms of Reference which were adopted by the Board of Directors on 24 September 2009.

The objectives of the Nomination Committee are:

- to ensure that the Company has a formal and transparent procedure for the appointment of new executive and non-executive Directors to the Board; and
- to ensure that the Company reviews the balance and effectiveness of the Board, identifying the skills needed and those individuals who might best provide them.

The Committee's terms of reference can be accessed on the Company's website.

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 release of announcements, trading updates and interim financial statements through the Regulatory News Service and on the Company's website,
- the full annual financial report is sent to all shareholders,

HYDRODEC GROUP PLC

CORPORATE GOVERNANCE STATEMENT

- 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 Notice of Annual General Meeting is included at the end of this document.

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

HYDRODEC GROUP PLC

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HYDRODEC GROUP PLC

We have audited the Group financial statements of Hydrodec Group plc for the year ended 31 December 2009 which comprise the consolidated statement of financial position, the consolidated statement of comprehensive income, the consolidated statement of cash flows, the consolidated statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of part 16 of the Companies Act 2006. 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 auditor's 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

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2009 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006

Emphasis of matter – Going concern

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in the section headed going concern within note 1 to the Group and Company financial statements concerning uncertainty over the future demand for and price of transformer oil as well as the availability of sufficient feedstock at an appropriate cost.

Should the Group not generate sufficient cash from its operations due to the uncertainties identified then there would be significant doubt over the Company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Company were unable to continue as a going concern.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Report of the Directors for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

HYDRODEC GROUP PLC

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HYDRODEC GROUP PLC

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the parent company financial statements of Hydrodec Group plc for the year ended 31 December 2009.

Charles Hutton-Potts BSc, FCA
Senior Statutory Auditor
for and on behalf of Grant Thornton UK LLP
Statutory Auditor, Chartered Accountants
London
27 April 2010

HYDRODEC GROUP PLC

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 DECEMBER 2009

		2009 USD'000	2008 USD'000
Revenue	Note 2	10,393	7,014
Cost of sales		(6,725)	(2,778)
Gross profit		3,668	4,236
Administrative expenses:			
Employee benefit expenses		(7,683)	(6,152)
Depreciation & amortisation		(3,250)	(2,330)
Other administrative expenses		(4,201)	(5,197)
Operating loss		(11,466)	(9,443)
Exceptional item – profit on sale of asset		595	–
Exceptional item – provision for investment loss	11	–	(3,608)
Interest payable	4	(2,691)	(2,994)
Interest receivable		3	577
Loss on ordinary activities before taxation		(13,559)	(15,468)
Tax on loss on ordinary activities	5	–	–
Loss for the year		(13,559)	(15,468)
Other comprehensive income			
Exchange differences on translating foreign operations		3,013	(3,346)
Total comprehensive loss for the year		(10,546)	(18,814)
Loss per share – basic and diluted	6	(5.46 cents)	(6.56 cents)

All transactions arise from continuing operations.

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

HYDRODEC GROUP PLC

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 DECEMBER 2009

	Note	2009 USD'000	2008 USD'000	2007 USD'000
Non-current assets				
Property, plant and equipment	7	24,543	22,948	13,502
Intangible assets	8	27,508	21,963	12,586
Other asset – prepaid royalty	9	–	3,705	–
		<u>52,051</u>	<u>48,616</u>	<u>26,088</u>
Current assets				
Trade and other receivables	10	1,902	1,622	1,496
Current asset investment	11	–	432	–
Inventories	12	403	135	312
Cash and cash equivalents		384	352	24,258
		<u>2,689</u>	<u>2,541</u>	<u>26,066</u>
Current liabilities				
Borrowings – bank overdraft		(123)	(249)	–
Trade and other payables	13	(3,645)	(3,176)	(2,388)
		<u>(3,768)</u>	<u>(3,425)</u>	<u>(2,388)</u>
Net current (liabilities)/assets		(1,079)	(884)	23,678
Non-current liabilities				
Employee provisions		(28)	–	–
Borrowings	14	(7,973)	(6,545)	(8,102)
Deferred taxation	15	(3,338)	(3,012)	–
		<u>(11,339)</u>	<u>(9,557)</u>	<u>(8,102)</u>
		<u>39,633</u>	<u>38,175</u>	<u>41,664</u>
Capital and reserves				
Called up share capital	16	2,734	2,014	1,938
Share premium account		54,223	38,500	38,058
Equity reserve		14,232	13,645	19,148
Merger reserve		47,718	43,058	–
Treasury reserve		(43,083)	(38,873)	–
Employee benefit trust		(1,298)	(1,170)	(568)
Share options reserve		5,513	4,210	4,954
Profit and loss account		(44,812)	(31,545)	(22,174)
Foreign exchange reserve		4,406	8,336	308
Total equity		<u>39,633</u>	<u>38,175</u>	<u>41,664</u>

The financial statements were approved by the Board of Directors on 27 April 2010 and were signed on its behalf by:

Neil Gaskell
Chairman

John Gunn
Deputy Chairman

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

HYDRODEC GROUP PLC

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 DECEMBER 2009

	2009 USD'000	2008 USD'000
Cashflows from/(used in) operating activities		
Loss before tax	(13,559)	(15,468)
Net finance costs	2,688	2,417
Exceptional item – provision for loss on disposal	–	3,608
Amortisation	1,954	1,678
Depreciation	1,296	652
(Gain)/Loss on disposal of fixed assets	(595)	33
Share based payment expense	828	788
Foreign exchange movement	(1,541)	2,027
(Increase)/decrease in inventories	(268)	117
(Increase)/decrease in amounts receivable	(269)	(535)
Increase in amounts payable	697	318
	<hr/>	<hr/>
Net cash outflow from operating activities	(8,769)	(4,365)
	<hr/>	<hr/>
Cashflows from/(used in) investing activities		
Purchase of property plant and equipment	(1,403)	(12,828)
Purchase of subsidiary undertaking	–	(9,709)
Proceeds from disposal of property plant and equipment	865	–
Proceeds from sale of investment	432	–
Royalty prepayment	–	(4,967)
Bank interest and other income received	3	577
	<hr/>	<hr/>
Net cash outflow from investing activities	(103)	(26,927)
	<hr/>	<hr/>
Cashflows from financing activities		
Issue of new shares	11,337	10,859
Costs of share issue	(517)	(297)
Purchase of share capital	–	(842)
Interest paid	(1,737)	(2,237)
Repayment of lease liabilities	(53)	(361)
	<hr/>	<hr/>
Net cash inflow from financing	9,030	7,122
	<hr/>	<hr/>
Increase / (decrease) in cash and cash equivalents	158	(24,170)
	<hr/>	<hr/>
Movement in net cash		
Cash	352	24,258
Bank overdraft	(249)	–
	<hr/>	<hr/>
Opening cash and cash equivalents	103	24,258
	<hr/>	<hr/>
Cash acquired with acquisition	–	15
Increase/(decrease) in cash and cash equivalents	158	(24,170)
	<hr/>	<hr/>
Closing cash and cash equivalents	261	103
	<hr/>	<hr/>

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

HYDRODEC GROUP PLC

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 DECEMBER 2009

	Share capital	Share premium	Equity reserve	Merger reserve	Treasury reserve	Employee benefit trust	Foreign exchange reserve	Share option reserve	Profit and loss account	Total
	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000
At 31 December 2007	1,938	38,058	19,148	–	–	(568)	–	4,954	(22,174)	41,356
Prior year adjustment	–	–	–	–	–	–	308	–	–	308
At 1 January 2008	1,938	38,058	19,148	–	–	(568)	308	4,954	(22,174)	41,664
Change in exchange rates	(533)	(10,466)	(5,266)	–	–	156	16,109	–	–	–
Share-based payment	–	–	–	–	–	–	–	618	–	618
Issue of shares	148	10,859	–	–	(941)	84	–	–	–	10,150
Acquisition	452	–	–	43,058	–	–	–	–	–	43,510
Issue costs	–	(297)	–	–	–	–	–	–	–	(297)
Purchase of shares	–	–	–	–	–	(842)	–	–	–	(842)
Acquisition	–	–	–	–	(37,932)	–	–	–	–	(37,932)
Conversion of loan stock	9	346	(237)	–	–	–	–	–	–	118
Transactions with owners	76	442	(5,503)	43,058	(38,873)	(602)	16,109	618	–	15,325
Change in exchange rates	–	–	–	–	–	–	(8,081)	(1,362)	6,097	(3,346)
Loss for the year	–	–	–	–	–	–	–	–	(15,468)	(15,468)
Total Comprehensive Income	–	–	–	–	–	–	(8,081)	(1,362)	(9,371)	(18,814)
At 31 December 2008	2,014	38,500	13,645	43,058	(38,873)	(1,170)	8,336	4,210	(31,545)	38,175
Change in exchange rates	218	4,176	1,479	4,660	(4,210)	(128)	(6,195)	–	–	–
Share-based payment	–	–	–	–	–	–	–	847	–	847
Issue of shares	468	10,869	–	–	–	–	–	–	–	11,337
Issue costs	–	(517)	–	–	–	–	–	–	–	(517)
Conversion of loan stock	34	1,195	(892)	–	–	–	–	–	–	337
Transactions with owners	720	15,723	587	4,660	(4,210)	(128)	(6,195)	847	–	12,004
Change in exchange rates	–	–	–	–	–	–	2,265	456	292	3,013
Loss for the year	–	–	–	–	–	–	–	–	(13,559)	(13,559)
Total Comprehensive Income	–	–	–	–	–	–	2,265	456	(13,267)	(10,546)
At 31 December 2009	2,734	54,223	14,232	47,718	(43,083)	(1,298)	4,406	5,513	(44,812)	39,633

A description of each reserve is set out in note 17.

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

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

I ACCOUNTING POLICIES

The Group's principal activity is the commercialisation of the Hydrodec technology which is a patented technology for the re-refining of used transformer oil into new SUPERfine™ transformer oil. Hydrodec Group plc is the Group's ultimate parent company. It is incorporated and domiciled in England and Wales and situated at 120 Moorgate, London. The Company's shares are listed on the Alternative Investment Market of the London Stock Exchange.

Basis of preparation

The Group's consolidated financial statements are prepared in accordance with the principal accounting policies adopted by the Group as set out below and International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations ("IFRIC") as adopted for use in the European Union (EU), and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

In the current year, the Group has adopted IAS 1 (revised) 'Presentation of Financial Statements', IFRS 7 'Financial Instruments: Disclosures' and IFRS 8 'Operating segments'. IAS 1 (revised) brings new disclosure requirements regarding owner and non-owner changes in equity which are now required to be shown separately. These financial statements have been prepared under the revised disclosure requirements which requires the presentation of a comparative balance sheet at the start of the comparative period. IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the Board. IFRS 7 requires enhanced disclosures about fair value measurement and liquidity risk.

The forthcoming standards may affect the preparation of the Group's financial statements in the future:

IFRIC 16: Hedges; and

IFRS 3 (Revised): Business combinations.

IFRS standards and interpretations not yet adopted

The IASB and IFRIC have issued the following standards and interpretations which are effective for periods starting after the date of these financial statements and are yet to be adopted by the Group:

- IFRS 9 Financial Instruments (effective 1 January 2013)
- Prepayments of a Minimum Funding Requirement - Amendments to IFRIC 14 (effective 1 January 2011)
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective 1 July 2010)
- Improvements to IFRSs (Issued 16 April 2009)
- Group Cash-settled Share-based Payment Transactions - Amendment to IFRS 2 (effective 1 January 2010)
- Amendment to IFRS 1 Additional Exemptions for First-time Adopters (effective 1 January 2010)
- IAS 24 (Revised 2009) Related Party Disclosures (effective 1 January 2011)

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material financial impact on the consolidated financial statements.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Presentational currency

In the current year the Group has changed its presentational currency from Sterling to US dollars. The change in presentational currency represents a change in accounting policy and in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', has been accounted for as a prior year adjustment. This has resulted in a cumulative amount of US\$0.3m being charged to the translation reserve at 31 December 2007, and a further US\$8.0m being charged in the year to 31 December 2008. This amount represents the translation difference arising from re-presenting the comparative figures through to 31 December 2008 in a different presentational currency (USD) from the historic functional currency of GBP. US dollars has been selected as the presentational currency as the Group's business is influenced by pricing in international commodity markets which is primarily dollar based.

The principal foreign exchange rates used in the preparation of these financial statements were:

	2009 Year end	2009 Average	2008 Year end	2008 Average	2007 Year end
In US dollars:					
UK Sterling	0.62	0.64	0.69	0.54	0.50
Australian dollars	1.12	1.26	1.45	1.17	1.13

The Group's reserves are translated using year end rates.

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.

Going concern

The financial statements have been prepared on the going concern basis, which assumes that the Group will have sufficient funds to continue in operational existence for the foreseeable future.

Currently, the Group is dependent upon its two plants to produce sufficient SUPERfine oil at satisfactory margins to generate sufficient cash to meet the Group's forecast requirements. Margins are affected by, amongst other things, the world price for oil and demand for transformer oil which are beyond the Directors' control and about which there is material uncertainty. The plants are also reliant on satisfactory production rates which are dependent on the availability of sufficient feedstock, and at the appropriate cost. Sensitivity to change on both criteria have been assessed by the Board.

The Directors are satisfied that at projected production, sales and margin rates the Group's operating cash flow requirements will be met.

The Directors believe that it is appropriate to prepare the financial statements on a going concern basis as they believe that the operating parameters outlined above will be met or exceeded.

Basis of consolidation

The Group financial statements consolidate those of the Company and its subsidiary undertakings drawn up to 31 December 2009. Subsidiaries are entities over which the Group has the power to control the financial and operating policies so as to obtain benefits from its activities.

Business combinations are dealt with by the purchase method. The purchase method involves the recognition at fair value of all identifiable assets and liabilities, including contingent liabilities of the subsidiary at the acquisition date whether or not they were recognised in the statements of the subsidiary prior to acquisition. On initial recognition the assets and liabilities of the subsidiary are included in the consolidated statement of financial

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

position at their fair values which are also used as the bases for subsequent measurement in accordance with the Group accounting policies. The results of any subsidiary undertakings acquired during the period, where applicable are included from the date of acquisition. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

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 at cost less any accumulated impairment losses.

Goodwill is not amortised but is subject to an impairment review on an annual basis or more frequently when events or changes in circumstances indicate it might be impaired. Any impairment is charged to the statement of comprehensive income in the period in which it arises.

Foreign currency translation

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

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 statement of comprehensive income with the exception of differences on translation of the net investment in a foreign Group entity. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the statement of comprehensive income. 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 statement of comprehensive income 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 foreign operations and translated at the closing rate.

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 the risks and rewards of ownership of the goods passes to the customer, which is normally upon delivery, and when the amount of revenue can be measured reliably.

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, using the effective interest method.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Other income

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

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 property, plant and equipment, 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 and residual values are re-assessed annually.

Patents

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

Research and development costs

Expenditure on research is recognised as an expense in the period in which it is incurred.

Development costs incurred on specific projects are capitalised when all the following conditions are satisfied:

- completion of the intangible asset is technically feasible so that it will be available for use or sale
- the Group intends to complete the intangible asset and use or sell it
- the Group has the ability to use or sell the intangible asset
- the intangible asset will generate probable future economic benefits. Among other things, this requires that there is a market for the output from the intangible asset or for the intangible asset itself, or, if it is to be used internally, the asset will be used in generating such benefits
- there are adequate technical, financial and other resources to complete the development and to use or sell the intangible asset, and
- the expenditure attributable to the intangible asset during its development can be measured reliably

Costs incurred which do not meet the above criteria are expensed as incurred.

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. 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.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

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 assets excluding goodwill

At each balance date, the Group reviews the carrying amounts of its property, plant and equipment 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.

Government grants

The Australian Government provides an incentive for product stewardship of used oil which is recognised on the same basis as revenue.

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.

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.

The fair value of the liability portion of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. The amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the bond. The remainder of the proceeds is allocated to the conversion option, which is recognised and included in shareholders equity.

Exceptional items

Exceptional items are those designated as material to the financial statements which are not expected to recur on a regular basis.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost 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.

All interest costs are charged to the income statement.

Share based payments

The Group issues equity-settled share-based payments to certain employees. Equity-settled 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.

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.

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method less provisions for impairment. Provision against trade receivables is made when there is objective evidence that the Group will not be able to collect all amounts due to it in accordance with the original terms of those receivables. The amount of the write-down is determined as the difference between the asset's carrying amount and the present value of estimated future cash flows.

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 lower of the present value of the minimum lease payments and fair value are recorded at the inception of the lease.

The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to the income statement over the period of the lease.

Operating leases

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

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Taxation

Current tax is the tax currently payable based on taxable profit for the year.

Deferred income taxes are calculated using the liability method on temporary differences. Deferred tax is generally provided on the difference between the carrying amounts of assets and liabilities and their tax bases. However, deferred tax is not provided on the initial recognition of goodwill, nor on the initial recognition of an asset or liability unless the related transaction is a business combination or affects tax or accounting profit. Deferred tax on temporary differences associated with shares in subsidiaries and joint ventures is not provided if reversal of these temporary differences can be controlled by the Group and it is probable that reversal will not occur in the foreseeable future. In addition, tax losses available to be carried forward as well as other income tax credits to the Group are assessed for recognition as deferred tax assets.

Deferred tax liabilities are provided in full, with no discounting. Deferred tax assets are recognised to the extent that it is probable that the underlying deductible temporary differences will be able to be offset against future taxable income. Current and deferred tax assets and liabilities are calculated at tax rates that are expected to apply to their respective period of realisation, provided they are enacted or substantively enacted at the balance sheet date.

Changes in deferred tax assets or liabilities are recognised as a component of tax expense in the income statement, except where they relate to items that are charged or credited directly to equity (such as the revaluation of land) in which case the related deferred tax is also charged or credited directly to equity.

Employee Benefit Trust

The assets and liabilities of the Employee Benefit Trust (EBT) have been included in the Group accounts. Any assets held by the EBT cease to be recognised on the Group balance sheet when the assets vest unconditionally in identified beneficiaries.

The costs of purchasing own shares held by the EBT are shown as a deduction against equity. The proceeds from the sale of own shares held increase equity. Neither the purchase nor sale of own shares leads to a gain or loss being recognised in the Group income statement.

Key judgements in applying the entity's accounting policies

In the process of applying the entity's accounting policies, which are described in this note, 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 and goodwill

The intangible assets carried forward relate to the intellectual property and goodwill acquired by the Group in 2004, and through the acquisition of Virotec International plc and reclassification of a royalty prepaid in 2008. The original cost of £19.5 million 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 (note 8).

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Convertible loan notes

The fair value of the loan notes is lower than the net proceeds. Management have applied their judgment in estimating the fair value of the loan element and in posting the corresponding credit to equity on the basis that the debt holder has an equity interest in the Company (note 14).

Impairment of goodwill and other intangibles

There are a number of assumptions Management have considered in performing impairment reviews of goodwill and intangible assets. In determining whether goodwill and intangible assets are impaired, an estimation of value in use of cash generating units to which goodwill and other intangible assets are allocated. The value in use calculation requires the Directors to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value (note 8).

Useful lives of property, plant and equipment

Property, plant and equipment is depreciated over its useful life. The useful life is based on the Management's estimates of the period that the assets will generate revenue, which are periodically reviewed for continued appropriateness. Changes to estimates can result in significant variations in the carrying value and amounts charged to the income statement in specific periods (note 7).

2 REVENUE AND OPERATING LOSS

Revenue and assets for both years are wholly attributable to the Group's sole activity of the treatment of used transformer oil and the sale of SUPERfine oil, which are deemed to be continuing activities. Revenue includes loss of profits insurance proceeds totalling USD1,022,000 for heater failures which caused a temporary shutdown of the Canton refinery.

Geographic analysis

	USA USD'000	Australia USD'000	Unallocated USD'000	Total USD'000
Year ended 31 December 2009				
Revenue	6,408	3,985	–	10,393
Non-current assets	16,494	15,422	20,135	52,051
Year ended 31 December 2008				
Revenue	398	6,616	–	7,014
Non-current assets	16,462	12,934	19,220	48,616

All revenue comprises amounts earned on amounts receivable from customers. During the year two customers in the USA each accounted for more than 10% of the Group's total revenue. Revenue recognised during the year and the amounts outstanding at the year end in respect of those customers were as follows:

	2009 Turnover USD'000	2009 Outstanding at year end USD'000	2008 Turnover USD'000	2008 Outstanding at year end USD'000
Customer 1	2,807	545	–	–
Customer 2	1,488	121	–	–

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

The loss on ordinary activities before taxation is stated after charging the following expenses:

	2009 USD'000	2008 USD'000
Cost of goods sold	6,725	2,778
Depreciation	1,296	652
Amortisation	1,954	1,678
Share based payments	828	789
Exchange losses	20	174
Operating lease rentals - land & buildings	96	45
Fees payable to the Company's auditor for the audit of the annual accounts	133	130
Fees payable to the Company's auditor and its associates for other services:		
– the audit of the Company's subsidiaries	28	56
– tax & other services	56	28
	<u>2009</u> USD'000	<u>2008</u> USD'000
Capital expenditure		
– property, plant and equipment	1,403	12,180
– intangible assets	–	13,975

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 DIRECTORS AND EMPLOYEES

The average number of persons (including Directors) employed by the Group during the year was:

	2009 Number	2008 Number
Operations	69	62
Corporate office	7	6
	<u>76</u>	<u>68</u>

The aggregate cost of these employees was:

	2009 USD'000	2008 USD'000
Wages and salaries	4,727	3,169
Payroll taxes	346	204
Share based payments	828	788
	<u>5,901</u>	<u>4,161</u>

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Directors emoluments paid during the period were:

	2009 USD'000	2008 USD'000
Emoluments	<u>896</u>	<u>860</u>

The highest paid Director received emoluments totalling USD222,000 (2008: USD246,000). Pension contributions for Directors totalled USD19,000 (2008: USD24,000).

Remuneration in respect of key management personnel was as follows:

	2009 USD'000	2008 USD'000
Emoluments	219	170
Share-based payments	196	231
	<u>415</u>	<u>401</u>

4 INTEREST PAYABLE

	2009 USD'000	2008 USD'000
Bank overdrafts & leases	107	87
Convertible loan stock	2,584	2,907
	<u>2,691</u>	<u>2,994</u>

5 TAX

	2009 USD'000	2008 USD'000
Current and total tax	<u>-</u>	<u>-</u>
Loss on ordinary activities before taxation	<u>(13,559)</u>	<u>(15,468)</u>
Rate of corporation tax in the United Kingdom of 28% (2008: 28.5%)	<u>(3,796)</u>	<u>(4,408)</u>
Effects of:		
Expenses not deductible for tax purposes	1,058	1,672
Tax losses not recognised	2,738	2,736
	<u>-</u>	<u>-</u>

A deferred tax asset of approximately USD7,105,000 (2008: USD3,885,000) in respect of losses against future taxable profits is not recognised due to the uncertainty of future taxable profits.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

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:

2009	2008
Number of	Number of
Shares	Shares
248,398,044	201,866,635

In 2008 and 2009, the share options were anti-dilutive and consequently no diluted earnings per share figure is included. The calculation of the weighted average number of shares excluded shares which are now held by a member of the Group and in respect of which votes may not be cast at a general meeting and also shares held by the Employee Benefit Trust.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

7 PROPERTY, PLANT AND EQUIPMENT

	Plant and equipment USD'000
Cost	
At 1 January 2007	7,693
Change in exchange rates	286
Additions	6,275
	<hr/>
At 31 December 2007	14,254
	<hr/>
Change in exchange rates	(1,780)
Additions	12,180
Disposals	(65)
	<hr/>
At 31 December 2008	24,589
	<hr/>
Change in exchange rates	2,568
Additions	1,403
Disposals	(345)
	<hr/>
At 31 December 2009	28,215
	<hr/>
Accumulated depreciation	
At 1 January 2007	165
Change in exchange rates	3
Depreciation charge for the year	584
	<hr/>
At 31 December 2007	752
	<hr/>
Change in exchange rates	402
Depreciation charge for the year	526
Disposals	(39)
	<hr/>
At 31 December 2008	1,641
	<hr/>
Change in exchange rates	752
Depreciation charge for the year	1,354
Disposals	(75)
	<hr/>
At 31 December 2009	3,672
	<hr/>
Carrying amount	
At 31 December 2009	24,543
	<hr/> <hr/>
At 31 December 2008	22,948
	<hr/> <hr/>

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. Depreciation was charged on additions comprising of plant and machinery in the United States of America for the first time in 2008.

The carrying amount of the Group's plant and equipment includes USD1,019,000 (2008: USD899,000) in respect of assets held under finance leases.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

8 INTANGIBLE ASSETS

	Royalty USD'000	Hydrodec Technology USD'000	Goodwill USD'000	Total USD'000
Cost				
At 1 January 2007	–	15,417	3,926	19,343
Exchange translation	–	315	80	395
At 31 December 2007	–	15,732	4,006	19,738
Exchange translation	–	(4,326)	(1,102)	(5,428)
Additions	–	10,963	3,012	13,975
At 31 December 2008	–	22,369	5,916	28,285
Exchange translation	–	2,423	641	3,064
Transfer from other non-current assets	5,023	–	–	5,023
Additions	–	–	422	422
At 31 December 2009	5,023	24,792	6,979	36,794
Accumulated amortisation and impairment				
At 1 January 2007	–	2,056	3,926	5,982
Exchange translation	–	42	80	122
Provided in year	–	1,048	–	1,048
At 31 December 2007	–	3,146	4,006	7,152
Exchange translation	–	(865)	(1,102)	(1,967)
Provided in year	–	1,137	–	1,137
At 31 December 2008	–	3,418	2,904	6,322
Exchange translation	–	370	315	685
Transfer from other non-current assets	626	–	–	626
Provided in the year	–	1,653	–	1,653
At 31 December 2009	626	5,441	3,219	9,286
Carrying amount				
At 31 December 2009	4,397	19,351	3,760	27,508
At 31 December 2008	–	18,951	3,012	21,963

The pre-paid royalty was recorded at cost in 2008 and amortised over its anticipated useful life, as determined by the volume of SUPERfine oil produced by the Group on which the royalty was payable. On 29 October 2009 the patents which were the subject of the pre-paid royalty were assigned to the Group for a nominal sum and transferred to intangible assets when a formal agreement was signed by Hydrodec Development Corporation Pty Ltd .

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

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

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 2009, the unamortised life of the asset was 11 years.

Goodwill of USD2,904,000 arose on the acquisition of Oil Treatment Services Pty Ltd in 2005, which has been fully provided for and the balance relates to the acquisition of Virotec International plc.

Impairment tests for intangibles

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The recoverable amounts of the cash generating unit ("CGU") are determined from value in use calculations.

Cash flow projections are derived from financial plans approved by the Board and cover a four year period. They reflect Management's expectations of revenue growth, operating cost and margin for the CGU based on past experience. After the four year forecast period, no further growth in revenue and profit has been assumed based on a prudent view of long term growth rates. A pre-tax discount rate of 14.5% has been applied to cash flow projections reflecting Management's assessment of the risk profiles for CGU.

The forecasts are most sensitive to changes considered possible by Management in projected revenue growth rates in the first three years of the forecast period. Total future forecast revenue would have to be 29% lower than currently projected before a possible impairment charge would be indicated.

9 OTHER NON-CURRENT ASSETS

	Pre-paid Royalty US'000
Cost	
At 1 January 2008	–
Addition	3,894
	<hr/>
At 31 December 2008	3,894
Exchange translation	1,129
Transfer to intangible assets	(5,023)
	<hr/>
At 31 December 2009	–
	<hr/>
Accumulated depreciation	
At 1 January 2008	–
Expensed during the year	189
	<hr/>
At 31 December 2008	189
Exchange translation	55
Expensed during the year	382
Transfer to intangible assets	(626)
	<hr/>
At 31 December 2009	–
	<hr/>
Carrying amount	
At 31 December 2009	–
	<hr/> <hr/>
At 31 December 2008	3,705
	<hr/> <hr/>

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

10 TRADE AND OTHER RECEIVABLES

	2009 USD'000	2008 USD'000	2007 USD'000
Trade receivables	1,319	826	998
Other receivables	127	255	220
Other taxation and social security	430	364	40
Prepayments and accrued income	26	177	238
	<u>1,902</u>	<u>1,622</u>	<u>1,496</u>

All trade receivable amounts are short term. All of the Group's trade and other receivables have been reviewed for indicators of impairment and no impairment indicators have been identified. The carrying value is considered a fair approximation of their fair value. No material amounts are past due date.

The carrying amounts of the Group's trade and other receivables are denominated in the following currencies:

	2009 USD'000	2008 USD'000	2007 USD'000
Sterling	442	362	123
Australian dollars	570	851	1,373
United States dollars	890	409	—
	<u>1,902</u>	<u>1,622</u>	<u>1,496</u>

11 CURRENT ASSET INVESTMENT

	2009 USD'000	2008 USD'000	2007 USD'000
Investment	—	432	—
	<u>—</u>	<u>432</u>	<u>—</u>

The investment in Molecra Group Limited was sold at its carrying amount on 5 February 2009.

12 INVENTORY

	2009 USD'000	2008 USD'000	2007 USD'000
Raw materials	92	31	8
Finished goods at cost	311	104	304
	<u>403</u>	<u>135</u>	<u>312</u>

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

13 TRADE AND OTHER PAYABLES

	2009 USD'000	2008 USD'000	2007 USD'000
Trade payables	870	1,536	1,580
Finance lease obligations	7	215	255
Other taxation and social security	726	517	77
Accruals and deferred income	2,042	908	476
	<u>3,645</u>	<u>3,176</u>	<u>2,388</u>

The carrying value of trade and other payables are considered to be a reasonable approximation of fair value.

14 NON-CURRENT LIABILITIES – BORROWINGS

	2009 USD'000	2008 USD'000	2007 USD'000
Convertible loan stock	7,139	5,866	7,436
Finance lease liabilities due within five years	834	679	666
	<u>7,973</u>	<u>6,545</u>	<u>8,102</u>

In November 2007, the Company issued a £13.8m convertible loan note which is convertible at the loan note holders option into ordinary share capital of the Company, at a fixed price of 17.65p (2008: 19p) per share, at any time between April 2008 and November 2012. Under the terms of the issue, the conversion price is revised for subsequent issues of share capital at discounts in excess of 10 per cent. to the prevailing 5 day share price average. Those elements not converted into shares by this date are repayable between 1 November 2012 and 31 October 2014. Interest is charged at a fixed rate of 8% per annum on the value of the unconverted loan.

	2009 USD'000	2008 USD'000	2007 USD'000
Face value of convertible bond issued	20,553	19,655	27,600
Issue costs	(672)	(609)	(838)
Equity component	<u>(14,232)</u>	<u>(13,645)</u>	<u>(19,148)</u>
Liability component	5,649	5,401	7,614
Interest expense	5,195	2,279	470
Interest payable	<u>(3,577)</u>	<u>(1,701)</u>	<u>(330)</u>
Liability component at 31 December	7,267	5,979	7,754
Unamortised issue costs	<u>(128)</u>	<u>(113)</u>	<u>(318)</u>
Net liability component at 31 December	<u>7,139</u>	<u>5,866</u>	<u>7,436</u>

Management recognise that the 8% interest rate is below market rate for this type of financial instrument and the fair value of the liability component was calculated using estimated interest rates for an equivalent non-convertible bond. The internal rate of return for the convertible bond has been assessed using comparable internal rates of return by the Group for other income streams. The residual amount representing the equity conversion option, is included in shareholders equity in other reserves.

During the year, loan notes with a value of US\$1,229,000 (2008: US\$355,000) were converted into share capital of the Company.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

15 DEFERRED TAXATION

	USD'000
Intangible assets on acquisition	
At 1 January 2007 and 31 December 2007	–
Addition	3,012
Transfer to/(from) income statement	–
	<hr/>
At 31 December 2008	3,012
Exchange translation	326
Transfer to/(from) income statement	–
	<hr/>
At 31 December 2009	3,338
	<hr/> <hr/>

16 SHARE CAPITAL

	2009 £'000	2008 £'000	2007 £'000
Authorised 800,000,000 ordinary shares of 0.5p each	4,000	4,000	4,000
	<hr/>	<hr/>	<hr/>
	Number of Shares	Number of Shares	Number of Shares
Issued and fully paid – ordinary shares of 0.5 pence each			
At the beginning of the year	277,824,101	193,845,400	184,645,400
Issued on acquisition	–	62,515,894	–
Treasury stock issued	–	2,173,335	–
Conversion of loan note	4,183,314	1,289,472	–
Issued for cash	58,181,457	18,000,000	9,200,000
	<hr/>	<hr/>	<hr/>
	340,188,872	277,824,101	193,845,400
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
	2009 USD'000	2008 USD'000	2007 USD'000
At the beginning of the year	2,014	1,938	1,809
Exchange translation	218	(533)	37
Issued on acquisition	–	452	–
Conversion of loan note	34	9	–
Issued for cash	468	148	92
	<hr/>	<hr/>	<hr/>
At the end of the year	2,734	2,014	1,938
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

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

Date of issue	Number of shares	Issue price pence	Total cash consideration USD'000
26 February 2009	19,230,114	10p	3,090
12 June 2009	1,973,684	19p	—
30 June 2009	22,857,143	14p	4,853
20 October 2009	2,209,630	17.65p	—
21 December 2009	16,094,200	12p	3,103

VIN Australia Pty Ltd, one of the subsidiary undertakings of the Group holds 54,500,000 ordinary shares in Hydrodec Group plc pursuant to the acquisition of Virotec International plc in 2008. Votes in respect of these shares, and a further 2,173,333 shares issued pursuant to that acquisition, may not be cast in a general meeting of Hydrodec Group plc and as such they are treated as if they were treasury shares on consolidation.

17 RESERVES

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

The equity reserve represents the equity element of the convertible bond.

The treasury reserves are shares held by a subsidiary undertaking in the parent company that were acquired as part of the acquisition of Virotec International plc.

The Employee Benefit Trust represents the value of shares held on trust for the benefit of employees.

The foreign exchange reserve records differences arising from the translation of the net investment in subsidiaries.

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

The merger reserve arose from the acquisition of Virotec International plc in 2008.

18 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 generally exercisable at a price equal to the quoted market price of the Company's shares on the date of grant. The vesting period for each grant is variable and typically between 1 and 5 years. A total of 4,000,000 options issued previously to previous directors of the Company lapsed during the year. No options were exercised in the year and 16,760,000 options were exercisable at prices between 11.5p and 33.25p at 31 December 2009 at a weighted average exercise price of 18.65p per share.

	Number	2009 Weighted average exercise price	Number	2008 Weighted average exercise price
At the beginning of the year	24,700,000	20.4p	21,700,000	18.1p
Issued in the year	3,200,000	14.6p	3,500,000	33.3p
Lapsed during the year	(4,000,000)	18.9p	—	—
Exercised during the year	—	—	(500,000)	11.3p
At the end of the year	23,900,000	19.7p	24,700,000	20.4p

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Fair value is determined by reference to the fair value of the instrument granted to the employee. 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. These fair values were calculated using a Black-Scholes option pricing model as follows:

	2009	2008
Weighted average share price	21.84p	21.0p
Weighted average exercise price	19.72p	20.4p
Expected volatility	83%	97%
Expected life	6.55yrs	8.0yrs
Risk free rate	5.0%	5.2%
Expected dividend yield	0.0%	0.6%

Expected volatility was assessed based on the volatility of the Company's shares since incorporation. The share options outstanding at the end of the year have exercise prices of between 11.5p and 33.25p per share. In the Directors' experience, the expected life of an employee share option is 10 years from the date of grant.

19 FINANCIAL INSTRUMENTS

Financial risk

The Group's financial instruments comprise cash, liquid resources and a convertible loan, and various items, such as trade receivables and trade payables 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, currency 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 0.0% during the year.

The convertible loan stock carries a fixed interest rate of 8% per annum on unconverted amounts. Interest costs of items acquired under lease arrangements are fixed at the time the lease is entered into for the term of the lease, which carry a weighted average interest cost of 7.5% per annum.

The Directors consider the only element of risk from changes in interest rates arises on bank deposits which is not expected to give rise to a material adjustment to the reported results for either 2009 or 2008.

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 US\$1,319,000 (2008: US\$826,000), and there are no material concentrations of credit risk.

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

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

Currency risk

The Group is exposed to translation and transaction foreign exchange risk. The currencies where the Group is most exposed to volatility are Sterling and Australian dollars.

Transactions and balances of entities within the Group are denominated in the local functional currencies and had the following balances denominated in GBP and Australian dollars:

	UK sterling		Australian dollars	
	2009 USD'000	2008 USD'000	2009 USD'000	2008 USD'000
Inventory	-	-	13	118
Trade and other receivables	437	245	570	851
Cash and cash equivalents	201	227	-	6
Borrowings	-	-	(123)	(249)
Trade and other payables	(1,311)	(594)	(1,352)	(558)

Currently, no hedging instruments are used. The Group keeps under review the extent of its exposure to currency fluctuations.

The following table illustrates the sensitivity of the net result for the year and equity in regards to the Group's financial assets and financial liabilities and the US dollar to British pound and Australian dollar exchange rates. It assumes a percentage change in the exchange rate based on the foreign currency financial instruments held at each balance sheet date. Both of these percentages have been determined based on the average market volatility in exchange rates in the previous 12 months.

	UK sterling		Australian dollars	
	2009	2008	2009	2008
Currency fluctuation	10%	10%	10%	10%

If the US dollar had strengthened against each currency by the percentage above retrospectively, then this would have had the following impact:

	2009 USD'000		2008 USD'000	
	GBP	AUD	GBP	AUD
Net result for the year	506	240	398	106
Equity	67	88	12	45

If the US dollar had weakened against the each currency by the percentage above retrospectively, then this would have had the following impact:

	2009 USD'000		2008 USD'000	
	GBP	AUD	GBP	AUD
Net result for the year	(506)	(240)	(398)	(106)
Equity	(67)	(88)	(12)	(45)

Exposure to foreign exchange rates vary during the year depending on the volume of overseas transactions. Nonetheless, the analysis above is considered to be representative of the Group's exposure to currency risk.

HYDRODEC GROUP PLC

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2009

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.

20 CAPITAL COMMITMENTS

At 31 December 2009, the Group had no capital commitments (2008: US\$nil)

21 CONTINGENT LIABILITIES

There were no contingent liabilities at 31 December 2009 or 31 December 2008.

22 FINANCIAL COMMITMENTS

The Group has entered into commercial leases on certain properties. There are no restrictions placed upon the lessee by entering into these leases.

The present value of future minimum rentals payable under non-cancellable operating leases are as follows:

	2009 USD'000	2008 USD'000
Within 1 year	81	55
Between 2 and 5 years	190	131
	<hr/> 271 <hr/>	<hr/> 186 <hr/>

23 RELATED PARTY TRANSACTIONS

AirTerAq, a company in which a Director, M D McNamara has an interest, supplied services to the value of USD277,522 during 2009 (2008: USD205,350) and was owed USDnil at 31 December 2009 (2008: USDnil). These services are for the provision of Mr McNamara as a Director of the Company.

Wengen Ltd, a company in which a Director, J Gunn has an interest, supplied services to the value of USD129,000 during 2009 (2008: USD83,000) and was owed USDnil at 31 December 2009 (2008:USDnil). These services are for the provision of Mr Gunn as a Director of the Company.

In May 2009 the Group sold its condition monitoring business (represented by a commercial oil analysis laboratory in Adelaide) for a total cash consideration of AUD800,000 to Healey Energy Services Pty Ltd, a company owned by Mr Russell Healey, a part-time executive of the Group who, at the relevant time, was a director of Hydrodec Australia Pty Ltd.

24 POST BALANCE SHEET EVENTS

On 13 January 2010, 29 March 2010 and 14 April 2010 the Group raised additional capital of USD0.3million, USD2.7million, and USD0.5million gross respectively through issues of new shares.

HYDRODEC GROUP PLC

INDEPENDENT AUDITOR'S REPORT 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 2009 which comprise the parent company balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of part 16 of the Companies Act 2006. 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 auditor's 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

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2009;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Emphasis of matter – Going concern

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in the section headed going concern within note 1 to the Group and Company financial statements concerning uncertainty over the future demand for and price of transformer oil as well as the availability of sufficient feedstock at an appropriate cost.

Should the Group not generate sufficient cash from its operations due to the uncertainties identified then there would be significant doubt over the Company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Company were unable to continue as a going concern.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the parent company financial statements.

HYDRODEC GROUP PLC

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HYDRODEC GROUP PLC

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of Hydrodec Group plc for the year ended 31 December 2009.

Charles Hutton-Potts BSc, FCA
Senior Statutory Auditor
for and on behalf of Grant Thornton UK LLP
Statutory Auditor, Chartered Accountants
London
27 April 2010

HYDRODEC GROUP PLC

COMPANY BALANCE SHEET

AS AT 31 DECEMBER 2009

	Note	2009 £'000	2008 £'000
Fixed assets			
Tangible fixed assets	28	39	—
Investments	29	24,884	30,037
		<u>24,923</u>	<u>30,037</u>
Current assets			
Debtors	30	1,080	977
Amounts due from subsidiary undertakings		27,449	22,558
Cash at bank		125	156
		<u>28,654</u>	<u>23,691</u>
Current liabilities			
Amounts due to subsidiary undertakings		(1,246)	(336)
Creditors: amounts falling due within one year	31	(815)	(509)
		<u>(2,061)</u>	<u>(845)</u>
Net current assets		<u>26,593</u>	<u>22,846</u>
Total assets less current liabilities		<u>51,516</u>	<u>52,883</u>
Non-current liabilities			
Creditors: amounts falling due after more than one year	32	(4,443)	(4,046)
		<u>47,073</u>	<u>48,837</u>
Capital and reserves			
Called up share capital	33	1,701	1,389
Share premium account	34	63,433	56,247
Equity reserve	34	8,856	9,411
Treasury reserve	34	(649)	(649)
Profit and loss account	34	(26,268)	(17,561)
Shareholders' funds	34	<u>47,073</u>	<u>48,837</u>

The financial statements were approved by the Board of Directors on 27 April 2010 and were signed on its behalf by:

Neil Gaskell

Chairman

John Gunn

Deputy Chairman

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

HYDRODEC GROUP PLC

NOTES TO THE COMPANY BALANCE SHEET

AS AT 31 DECEMBER 2009

25 SIGNIFICANT ACCOUNTING POLICIES

The separate financial statements of the Company are presented as required by the Companies Act 2006. 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 of the Company are set out below.

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

Going concern

The financial statements have been prepared on the going concern basis, which assumes that the Group will have sufficient funds to continue in operational existence for the foreseeable future.

Currently, the Group is economically dependent upon the two plants to produce sufficient SUPERfine oil at satisfactory margins to sustain adequate cash flow to meet the Group's requirements. Margins are affected by, amongst other things, the world price for oil and demand for transformer oil about which there is material uncertainty and which is beyond the Directors' control. They are also reliant on satisfactory production rates which are dependent on the availability of feedstock, and at the appropriate cost. Sensitivity to change on both criteria have been assessed by the Board.

The Directors are satisfied that at projected production, sales and margin rates the Group's operating cash flow requirements will be met.

The Directors believe that it is appropriate to prepare the financial statements on a going concern basis as they believe that the operating parameters outlined above will be met or exceeded.

Investments

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

Financial liabilities and equity

Financial liabilities and equity instruments issued by the Company 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 Company after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

The fair value of the liability portion of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. The amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the bond. The remainder of the proceeds is allocated to the conversion option, which is recognised and included in shareholders equity.

Tangible fixed assets and depreciation

Depreciation is calculated to write down the cost less estimated residual value of all tangible fixed assets other than freehold land by equal annual instalments over their expected useful lives. The rates generally applicable are:

Fixtures, fittings and equipment	20% straight line
----------------------------------	-------------------

HYDRODEC GROUP PLC

NOTES TO THE COMPANY BALANCE SHEET

AS AT 31 DECEMBER 2009

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost 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.

All interest costs are charged to the income statement.

Taxation

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.

26 DIRECTORS AND EMPLOYEES

The average number of employees of the Company during the year was:

	2009 Number	2008 Number
Corporate office	<u>7</u>	<u>6</u>

Staff costs during the year were as follows:

	2009 £'000	2008 £'000
Wages and salaries	667	465
Social security costs	12	7
Share based payment charge	527	426
	<u>1,206</u>	<u>898</u>

Directors emoluments paid during the year were:

	2009 £'000	2008 £'000
Emoluments	<u>570</u>	<u>465</u>

The highest paid Director received emoluments totalling £142,000 (2008: £133,000). Pension contributions for Directors totalled £12,000 (2008: £13,000).

27 LOSS ATTRIBUTABLE TO THE SHAREHOLDERS OF THE COMPANY

The Company is an investment holding company. As permitted by section 408 of the Companies Act 2006, the Company's profit and loss account has not been included in these accounts. The loss on ordinary activities attributable to shareholders of the Company dealt with in these accounts was £8,707,022 (2008: £15,992,000).

HYDRODEC GROUP PLC

NOTES TO THE COMPANY BALANCE SHEET AS AT 31 DECEMBER 2009

28 TANGIBLE FIXED ASSETS

	Fixtures and equipment £'000
Cost	
At 1 January 2009	–
Additions	41
	<hr/>
At 31 December 2009	41
	<hr/>
Provisions	
At 1 January 2009	–
Provided in year	2
	<hr/>
At 31 December 2009	2
	<hr/>
Net book values	
At 31 December 2009	39
	<hr/> <hr/>
At 31 December 2008	–
	<hr/> <hr/>

29 INVESTMENTS

	Shares in subsidiary undertakings £'000	Loans to subsidiary undertakings £'000	Total £'000
Cost			
At 1 January 2009	42,876	611	43,487
Additions	336	–	336
	<hr/>	<hr/>	<hr/>
At 31 December 2009	43,212	611	43,823
	<hr/>	<hr/>	<hr/>
Provisions			
At 1 January 2009	13,450	–	13,450
Provided in year	5,489	–	5,489
	<hr/>	<hr/>	<hr/>
At 31 December 2009	18,939	–	18,939
	<hr/>	<hr/>	<hr/>
Net book values			
At 31 December 2009	24,273	611	24,884
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
At 31 December 2008	29,426	611	30,037
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

The impairments made are to write the investment down to the underlying market value of the investments held by the subsidiary undertakings in listed investments. The additions in 2009 relate to sundry acquisition costs related to the prior year acquisition of Virotec International Plc.

HYDRODEC GROUP PLC

NOTES TO THE COMPANY BALANCE SHEET

AS AT 31 DECEMBER 2009

The subsidiary undertakings at 31 December 2009 are 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
Hydrodec North American Holdings Inc	USA	100%	Holding company
Hydrodec North America LLP**	USA	100%	Oil treatment services
Virotec International plc	UK	100%	Holding company
VIN Australia Pty Ltd***	Australia	100%	Investment company

* Held through Hydrodec Development Corporation Pty Limited

** Held through Hydrodec North American Holdings Inc

*** Held through Virotec International plc

30 DEBTORS

	2009 £'000	2008 £'000
Other debtors	272	169
Employee benefit trust	808	808
	<u>1,080</u>	<u>977</u>

31 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2009 £'000	2008 £'000
Trade creditors	88	12
Other creditors	125	75
Accruals	602	422
	<u>815</u>	<u>509</u>

32 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2009 £'000	2008 £'000
Convertible loan stock	4,443	4,046
	<u>4,443</u>	<u>4,046</u>

In November 2007, the Company issued a £13.8m convertible loan note which is convertible at the loan note holders option into ordinary share capital of the Company at a fixed price of 17.65p per share at any time between April 2008 and November 2012. Those elements not converted into shares by this date are repayable between 1 November 2012 and 31 October 2014. Under the terms of the issue, the conversion price is revised for subsequent issues of share capital at discounts in excess of 10 per cent to the prevailing 5 day share price average. Interest is charged at a fixed rate of 8% per annum on the value of the unconverted loan. During the year, loan notes with a value of £765,000 (2008: £245,000) were converted into share capital of the Company.

HYDRODEC GROUP PLC

NOTES TO THE COMPANY BALANCE SHEET

AS AT 31 DECEMBER 2009

	2009 £'000	2008 £'000
Face value of convertible bond issued	12,790	13,555
Issue costs	(419)	(419)
Equity component	(8,856)	(9,411)
	<hr/>	<hr/>
Liability component	3,515	3,725
Interest expense	3,233	1,572
Interest payable	(2,226)	(1,172)
	<hr/>	<hr/>
Liability component at 31 December 2009	4,522	4,125
Unamortised issue costs	(79)	(79)
	<hr/>	<hr/>
	4,443	4,046
	<hr/> <hr/>	<hr/> <hr/>

Management recognise that the 8% interest rate is below market rate of this type of financial instrument and the fair value of the liability component was calculated using estimated interest rates for an equivalent non-convertible bond. The internal rate of return for estimated for the convertible bond has been assessed using comparable internal rates of return used by the Group for other income streams. The residual amount representing the equity conversion option, is included in shareholders equity in other reserves.

33 SHARE CAPITAL

	2009 £'000	2008 £'000
Authorised 800,000,000 ordinary shares of 0.5p each	4,000	4,000
	<hr/> <hr/>	<hr/> <hr/>
	£'000	£'000
Issued and fully paid - 340,188,872 ordinary shares of 0.5 pence each (2008: 277,824,101)	1,701	1,389
	<hr/> <hr/>	<hr/> <hr/>

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

Date of issue	Number of shares	Issue price pence	Total cash consideration £'000
26 February 2009	19,230,114	10p	1,923
12 June 2009	1,973,684	19p	-
30 June 2009	22,857,143	14p	3,200
20 October 2009	2,209,630	17.65p	-
21 December 2009	16,094,200	12p	1,931

HYDRODEC GROUP PLC

NOTES TO THE COMPANY BALANCE SHEET

AS AT 31 DECEMBER 2009

34 RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	Share capital £'000	Share premium account £'000	Equity reserve £'000	Treasury reserve £'000	Profit and loss account £'000	Total £'000
At 1 January 2009	1,389	56,247	9,411	(649)	(17,561)	48,837
Share issues	312	6,763	–	–	–	7,075
Issue costs	–	(321)	–	–	–	(321)
Conversion of loan stock	–	744	(555)	–	–	189
Loss for the financial year	–	–	–	–	(8,707)	(8,707)
At 31 December 2009	1,701	63,433	8,856	(649)	(26,268)	47,073

35 RELATED PARTY TRANSACTIONS

There were no related party transactions between the Company and its subsidiaries.

HYDRODEC GROUP PLC

NOTICE OF ANNUAL GENERAL MEETING

Hydrodec Group plc

*(Incorporated and registered in England and Wales
under the Companies Act 1985 with registered no. 05188355)*

NOTICE IS HEREBY GIVEN THAT the Annual General Meeting of Hydrodec Group plc (the “**Company**”) will be held at the offices of Numis Securities Limited, The London Stock Exchange Building, 10 Paternoster Square, London EC4M 7LT at 10.00 a.m. on 27 May 2010. The business of the meeting will be to consider and, if thought fit, to pass the following resolutions (the “**Resolutions**”), of which Resolutions 1 to 4 will be proposed as ordinary resolutions of the Company and Resolutions 5 and 6 will be proposed as special resolutions of the Company:

ORDINARY BUSINESS:

- 1 To receive and adopt the report of the Directors and the audited accounts of the Company for the year ended 31 December 2009 together with the report of the auditors thereon.
- 2 To re-elect John Gunn who retires by rotation pursuant to Article 92 of the Company’s Articles of Association and who, being eligible, offers himself for re-election as a Director.
- 3 To re-appoint Grant Thornton UK LLP as auditors of the Company from the conclusion of this meeting until the conclusion of the next general meeting at which accounts are laid before the Company and to authorise the Directors to fix their remuneration.

SPECIAL BUSINESS:

- 4 **THAT** the directors of the Company (“**Directors**”) be and they are hereby generally and unconditionally authorised in accordance with section 551 Companies Act 2006 (“**CA 2006**”) to exercise all the powers of the Company to allot shares in the Company and to grant rights to subscribe for, or to convert any security into, shares in the Company:
 - A. up to an aggregate nominal amount of £600,000; and
 - B. comprising equity securities (within the meaning of section 560 CA 2006) up to a further aggregate nominal amount of £600,000 in connection with an offer by way of a rights issue:
 - i. to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
 - ii. to holders of other equity securities as required by the rights of those securities or as the Directors otherwise consider necessary,

and so that that Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or the requirements of any regulatory body or stock exchange or any other matter (including any such problems arising by virtue of equity securities being represented by depositary receipts).

The authorities conferred on the Directors under paragraphs (A) and (B) above shall expire at the conclusion of the next annual general meeting of the Company after the passing of this Resolution or 15 months after the passing of this Resolution, whichever is the earlier save that the Company may before

HYDRODEC GROUP PLC

NOTICE OF ANNUAL GENERAL MEETING

such expiry make an offer or agreement which would or might require shares to be allotted or rights to subscribe for, or to convert any security into, shares to be granted after such expiry and the Directors may allot shares or grant rights to subscribe for, or to convert any security into, shares (as the case may be) in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

5 **THAT** the Directors be and they are empowered pursuant to sections 570 and 573 of the CA 2006 to allot equity securities (within the meaning of section 560 of the CA 2006) for cash pursuant to the authority conferred under Resolution 4, as if section 561(1) of the CA 2006 did not apply to such allotment provided that the power conferred by this resolution shall be limited to:

- (i) the allotment of equity securities of the Company in connection with an issue or offer of equity securities to the holders of ordinary shares in the capital of the Company in proportion (as nearly as may be) to their existing holdings of such shares (excluding any shares held by the Company as treasury shares (within the meaning of section 724 of the CA 2006)) on the record date for such allotment or in accordance with the rights attached to such shares but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or as a result of legal or practical problems under the laws of, or the requirements of any regulatory body or any stock exchange, in any territory;
- (ii) pursuant to the grant or exercise of any share options pursuant to any share option scheme of the Company in force from time to time; and
- (iii) the allotment, otherwise than pursuant to paragraphs (i) and (ii) above, of equity securities of the Company up to an aggregate nominal value equal to £181,000;

and unless previously renewed, revoked, varied or extended this power shall expire on the earlier of the date which is 15 months from the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company except that the Company may before the expiry of this power make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if this power had not expired.

6 **THAT** the Company be and is hereby generally and unconditionally authorised, pursuant to and in accordance with section 701 of the CA 2006, to make market purchases (within the meaning of section 693(4) of the CA 2006) of ordinary shares of 0.5 pence each in the capital of the Company ("**Ordinary Shares**") on such terms and in such manner as the Directors shall from time to time determine, provided that:

- (i) the maximum aggregate number of Ordinary Shares hereby authorised to be purchased is 54,241,994;
- (ii) the minimum price which may be paid for an Ordinary Share is its nominal value;
- (iii) the maximum price (exclusive of expenses) which may be paid for an Ordinary Share is not more than the higher of 105 per cent. of the average of the middle market quotations of an Ordinary Share (as derived from AIM) for the five business days immediately preceding the date on which that Ordinary Share is contracted to be purchased and an amount equal to the higher of the price of the last independent trade of an Ordinary Share and the highest current independent bid for an Ordinary Share at the time the purchase is carried out;

HYDRODEC GROUP PLC

NOTICE OF ANNUAL GENERAL MEETING

- (iv) the authority hereby conferred shall expire at the conclusion of the next Annual General Meeting of the Company following the passing of this resolution, unless previously revoked, varied or renewed by the Company in general meeting; and
- (v) the Company may at any time prior to the expiry of such authority make a contract or contracts to purchase ordinary shares under such authority which will or might be completed or executed wholly or partly after the expiration of such authority and may make a purchase of ordinary shares in pursuance of any such contract or contracts.

By Order of the Board
Michael Preen
Company Secretary

Registered Office
120 Moorgate
London
EC2M 6SS

27 April 2010

HYDRODEC GROUP PLC

NOTICE OF ANNUAL GENERAL MEETING

NOTES:

1. A member of the Company entitled to attend, speak and vote at this meeting is entitled to appoint one or more proxies to attend, speak and vote in that member's place. A member may appoint more than one proxy in relation to this meeting provided that each proxy is appointed to exercise rights attached to a different share or shares held by that member. A proxy need not also be a member. Completion and return of a Form of Proxy (or any CREST Proxy Instruction, as described in notes 6 to 8) will not preclude a member from attending and voting at the meeting should the member so decide. A Form of Proxy accompanies this notice. If you wish to appoint multiple proxies please photocopy the Form of Proxy, fill in each copy in respect of different shares and send the multiple forms together to the Company's registrars, Capita Registrars in accordance with note 2 below. Alternatively you may appoint multiple proxies by CREST Proxy Instruction in accordance with note 6 below.
2. To be valid, the enclosed Form of Proxy and any power of attorney or other authority (if any) under which it is signed (or a copy certified notarially, or in some other manner approved by the Board) must be completed and returned so as to reach the Company's registrars, Capita Registrars, PXS, 34 Beckenham Road, Beckenham, BR3 4TU by 10.00a.m. on 25 May 2010 (or, if the meeting is adjourned, not less than 48 hours before the time fixed for the holding of the adjourned meeting).
3. In the event that a poll is demanded at the meeting, and such poll is to be taken more than 48 hours thereafter, the enclosed Form of Proxy (together with any documents of authority required by note 2) may be returned to the Company's registrars, Capita Registrars at the address in note 2 above so as to arrive not later than 24 hours before the time appointed for such poll. In the event that a poll is demanded at the meeting, and such poll is not taken at the meeting, but is taken less than 48 hours after the meeting, the enclosed Form of Proxy (together with any documents of authority required by note 2) may be delivered at the meeting to the chairman of the meeting or to the secretary or any director of the Company.
4. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, to be entitled to attend and vote at the Annual General Meeting (and for the purpose of determining the number of votes a member may cast), members must be entered on the Register of Members of the Company by 6.00 p.m. on 25 May 2010.
5. In the case of joint holders, the signature of only one of the joint holders is required on the form of proxy, but the vote of the senior (by order in the register of members) who tenders a vote will be accepted to the exclusion of the others.
6. CREST members who wish to appoint a proxy or proxies by utilising the CREST electronic proxy appointment service may do so for this meeting and any adjournment(s) thereof by utilising the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
7. In order for a proxy appointment made by means of CREST to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's ("Euroclear") specifications and must contain the information required for such instructions, as described in the CREST Manual. The message must be transmitted so as to be received by the Company's agent (ID RA10) by the latest time for proxy appointments set out in note 2 above. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the Company's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

HYDRODEC GROUP PLC

NOTICE OF ANNUAL GENERAL MEETING

8. CREST members and, where applicable, their CREST sponsors or voting service providers should note that Euroclear does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting service providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
9. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

HYDRODEC GROUP PLC

EXPLANATORY INFORMATION FOR THE RESOLUTIONS

The following explanatory information is provided by way of background to the special business of the meeting:

Authority of Directors to allot shares (Resolution 4 – ordinary resolution)

The authority given to the Directors to allot further shares in the capital of the Company requires the prior authorisation of the shareholders in general meeting under section 551 Companies Act 2006. The authority granted at the Company's last general meeting is due to expire at this year's Annual General Meeting. Accordingly, Resolution 4 will be proposed as an ordinary resolution to grant new authorities to allot shares and grant rights to subscribe for, or convert any security into, shares (a) up to an aggregate nominal amount of £600,000 and (b) in connection with a rights issue up to an aggregate nominal amount (when added to allotments under part (a) of the resolution) of £1,200,000. These amounts represent approximately one third and approximately two thirds respectively of the total issued ordinary share capital of the Company, in accordance with current guidelines. This authority will expire immediately following the Annual General Meeting in 2011 or, if earlier, fifteen months following the Resolution being passed.

Disapplication of pre-emption rights (Resolution 5 – special resolution)

If the Directors wish to exercise the authority under Resolution 4 and offer shares for cash, the Companies Act 2006 requires that, unless shareholders have given specific authority for the waiver of the statutory pre-emption rights, the new shares be offered first to existing shareholders in proportion to their existing shareholdings. In certain circumstances, it may be in the best interests of the Company to allot new shares (or to grant rights over shares) for cash without first offering them to existing shareholders in proportion to their holdings. The authority granted at the Company's last general meeting is due to expire at this year's Annual General Meeting. Accordingly, Resolution 5 would authorise the Directors to disapply the strict statutory pre-emption provisions.

This would provide the Directors with a degree of flexibility to act in the best interests of the Company by allotting shares for cash (i) by way of a rights issue, open offer or other offer of securities in favour of existing shareholders in proportion to their shareholdings (subject to certain exclusions) and (ii) to persons other than existing shareholders up to an aggregate nominal value of £181,000 which is equivalent to approximately 10 per cent of the Company's issued share capital. This authority will expire immediately following the Annual General Meeting in 2011 or, if earlier, fifteen months following the Resolution being passed.

Authority for the Company to purchase its own shares (Resolution 6 – special resolution)

The Company's articles of association permit the purchase by the Company of its own shares subject to shareholders' prior approval being obtained.

The authority granted at last year's Annual General Meeting is due to expire at this year's Annual General Meeting. Accordingly, this Resolution is to authorise the Company to buy back up to 54,241,994 Ordinary Shares. The authority would expire at the conclusion of the 2011 Annual General Meeting or, if earlier, 15 months following the Resolution being passed.

The Resolution specifies the maximum number of Ordinary Shares which may be purchased (representing 14.99 per cent of the Company's issued share capital) and the maximum and minimum prices at which they may be bought, reflecting the requirements of the Companies Act 2006.

The Board has no present intention of exercising this power and the granting of this authority should not be taken to imply that any Ordinary Shares will be purchased. No purchase of Ordinary Shares will be made unless it is expected that the effect will be to increase earnings per share and the Board considers it to be in the best interests of all shareholders.

HYDRODEC GROUP PLC

EXPLANATORY INFORMATION FOR THE RESOLUTIONS

Action to be taken

You will find enclosed a form of proxy for use at the AGM. Please complete, sign and return the enclosed form as soon as possible in accordance with the instructions printed thereon, whether or not you intend to be present at the AGM. Forms of proxy should be returned so as to be received by Capita Registrars, PXS, 34 Beckenham Road, Beckenham, BR3 4TU as soon as possible and in any event no later than 48 hours before the time appointed for holding the AGM.

Recommendation

Your Directors consider that all the resolutions to be put to the meeting are in the best interests of the Company and its shareholders as a whole and unanimously recommend shareholders to vote in favour of all the resolutions, as they intend to do in respect of their own beneficial holdings.