



**HYDRODEC GROUP PLC**  
CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
31 DECEMBER 2008







# HYDRODEC GROUP PLC

## DIRECTORS, SECRETARY AND ADVISERS

Company registration number:	5188355
Registered office:	6th Floor 80 Cannon Street London EC4N 6HL
Directors:	J H Gunn (Non-executive chairman) R N Gaskell(Non-executive deputy chairman) M D McNamara (Chief executive officer) J W Dickson (Finance director) J G Cowan (Sales and marketing director) R D Sargent (Non-executive director) G M Leates (Non-executive director)
Secretary:	J W Dickson
Nominated adviser and broker:	Numis Securities Ltd The London Stock Exchange Building 10 Paternoster Square London EC4M 7LT
Bankers:	JP Morgan Chase
Solicitors:	Pinsent Masons LLP CityPoint One Ropemaker Street London EC2Y 9AH
Registrars:	Capita Registrars Ltd The Registry 34 Beckenham Road Beckenham Kent BR3 4TU
Auditor:	Grant Thornton UK LLP Registered Auditor Chartered Accountants Grant Thornton House Melton Street Euston Square London NW1 2EP

# HYDRODEC GROUP PLC

## CONTENTS

	<b>PAGE</b>
Chairman's statement	2 – 4
Report of the directors	5 – 8
Corporate governance statement	9 – 11
Report of the independent auditor	12 – 13
Consolidated income statement	14
Consolidated balance sheet	15
Consolidated cash flow statement	16
Consolidated statement of changes in equity	17
Notes to the consolidated financial statements	18 – 39
Report of the independent auditor	40 – 41
Company balance sheet	42
Notes to the company balance sheet	43 – 47

# HYDRODEC GROUP PLC

## CHAIRMAN'S STATEMENT

### Introduction

I am pleased to present Hydrodec's results for the year ended 31 December 2008. Hydrodec's technology is an oil refining process, producing new speciality oils, using spent oil as the primary feedstock. The Company currently has plants in Young, NSW Australia and Canton, Ohio, producing SUPERfine™ transformer oil.

### Results for year ended 31st December 2008

Turnover for the year increased by 205% to £3.8 million (2007: £1.9 million), with an overall net operating loss of £8.4 million (2007: £2.3 million). The operating loss includes £6.1 million (2007: £1.6 million) of non-cash items due primarily to the write-off of investments acquired as part of the Virotec transaction, options expensed during the year, as well as depreciation and amortization of the intangible assets acquired. The operating loss before non-cash items was £2.3 million (2007: £0.7 million). Net assets were £26.3 million (2007: £20.8 million).

### Market conditions

The unprecedented recent economic conditions adversely effected Hydrodec in 2008 and early 2009. In particular, the collapse in the global crude oil price impacted the Company during a crucial period, as it was generating first production from the Ohio plant and negotiating significant SUPERfine™ supply contracts at the time. During Q4 2008 and Q1 2009, the Board took the strategically difficult decision not to commit to long-term contracts at such historically low oil prices. We believe that this was the correct decision, as there has been significant improvement in both transformer and crude oil prices throughout 2009.

Whilst the Board believes that the Company has, and will continue to, benefit from this decision in 2009 and beyond, the Company experienced working capital constraints as it had geared up for production in Canton, in particular by building up high levels of feed-stock. As a result, two placings of new equity were made, in November 2008 and February 2009, together raising £3.9 million (before expenses). These placings have allowed the Company to take long-term decisions on pricing and SUPERfine™ supply.

### Canton

Over the course of the year, the Canton facility has developed from a historic brownfield site to a commercial operating plant. On 22 July 2008, final stage commissioning was completed and the first stage of operations of the Canton plant commenced as oil feedstock was run through the reactors under operating conditions for the first time. On 18 December 2008, Hydrodec received verification that Canton SUPERfine™ had passed independent quality assurance verification, following which samples were sent to many customers for their approval. The 22,000 square foot plant was officially opened by the Mayor of Canton on 8 October 2008 and on 23 October 2008 the first bulk shipment of product to a customer in Maryland was made.

### Young

The Young plant operated for the entire year, producing 3.4 million litres of oil, and made an operating profit of AU\$600,000, a tremendous achievement given the economic back drop within which it was operating. The Young plant managed to maintain good margins, which is a testament to the quality of SUPERfine™ and its growing acceptance in the Australian market.

### Fundraising

On April 21 2008, a placing of approximately 10 million new ordinary shares of 0.5 pence each in the Company ("Ordinary Shares") raised £5 million (before expenses) to fund the acquisition of Virotec and general corporate purposes, including further expansion of the Company's activities.

On 26 November 2008, a placing of approximately 8 million new Ordinary Shares raised £2 million (before expenses) to fund working capital requirements and allow the Company to continue to pursue opportunities within the Japanese and hydraulic oil markets.

Following the year end, on 23 February 2009, a placing of approximately 19 million new Ordinary Shares raised £1.9 million (before expenses) to fund working capital requirements.

### Corporate activity

The acquisition of Virotec, via a scheme of arrangement for aggregate consideration of £39 million was completed in June 2008. The consideration was a mixture of new equity and cash and as a result 64,689,227 new Ordinary Shares were issued.

Certain operating businesses within Virotec were not acquired, primarily leaving Hydrodec with 54.4 million Hydrodec shares and 30 million shares in Molecra Group Ltd ("Molecra"). Post year end, on 4 February 2009, the Molecra

# HYDRODEC GROUP PLC

## CHAIRMAN'S STATEMENT

shares were sold for aggregate gross consideration of £300,000, leading to a substantial non-cash loss of £1,950,000. The consideration received was a reflection of the significant deterioration in Molecra's share price due to prevailing market conditions. As the asset was held for resale, the value was adjusted to reflect this deterioration.

On 5 June 2008, Hydrodec announced the complete pre-payment and cancellation of a 5% royalty that was payable to CSIRO for the life of the patent, for £2.75m (AU\$5.6m).

### Trading update

The Company is pleased with progress made despite the current recessionary environment and remains confident of reporting a profit from its operations in the current financial year.

### United States

The global price of crude oil and the transformer oil market both appear to have stabilised and started to recover after the lows of January and February this year. West Texas Intermediate (WTI) Crude is a key index used in establishing US transformer oil pricing and has increased by approximately 50% since the early 2009 lows. Feedstock prices have also stabilised and the average feedstock cost to Hydrodec has reduced by approximately 40% since February.

Since the financial year end of 31 December 2008, Hydrodec has announced two significant agreements. The Company entered into a 3 year agreement with Consolidated Edison Company of New York ("Con Edison") through which Hydrodec will receive all of Con Edison's used transformer oil. The agreement provides for approximately 450,000 gallons per annum to be received at the Ohio plant which will be re-refined into SUPERfine™.

Hydrodec also concluded an agreement to receive all of Exelon's used transformer oil (approximately 650,000 gallons per year) and re-refine it into SUPERfine™. The Chicago-based electric utility ComEd has committed to purchase back this re-refined SUPERfine™, effectively creating a closed-loop supply chain for transformer oil.

The Board considers that the forward sales of SUPERfine™ transformer oil are encouraging and the Canton plant is expected to achieve full operational capacity in 2009. The Group has also secured committed feedstock supply in excess of 90% of current available plant capacity and the Board continues to identify additional probable feedstock sources. The Board believes that demand and market conditions are continuing to improve and this has encouraged the Board to consider plans for a second US plant or an expansion of the Canton plant. These plans are expected to firm up in the second half of 2009 following an evaluation of potential logistical and financing arrangements.

### Australia

The Australian plant has recently successfully completed its first full catalyst change since commissioning. The change was completed smoothly as planned and with minimal interruption to normal operations. This plant continues to run consistently and reliably. The Australian facility also continues to provide systems, process and product development support for all activities across the Group.

On 12 May 2009, the Company sold the non-core Condition Monitoring Business for a total consideration of AU\$800,000. AU\$600,000 was received immediately and AU\$200,000 is expected to be received on 11 July 2009.

### Japan

Demonstration trials for the benefit of the Japanese Environment Ministry have been completed under witness by Japanese representatives in the Young, NSW plant. The Company awaits the results of the trial and Japanese government approval of Hydrodec's technology for commercial application in Japan. Negotiations with the prospective Japanese partner continue to progress.

### Placing and General Meeting

On the 12 June, the Company announced the intention to raise approximately £3.2 million (before expenses) by way of a conditional placing ("Placing") of 22,857,143 new Ordinary Shares at 14p each ("Placing Price").

The Placing is being carried out to enable the Company to pursue its expansion aspirations from a more sound capital base and is also expected to help facilitate the procurement of additional capital for new plants proposed to be built in the United States and Japan in response to strong product demand. The net proceeds of the Placing will be used, primarily, to fund the ongoing working capital requirements of the Group and as seed capital for the proposed new plants. This seed capital will be used to secure the appropriate sites for the plants, the necessary approvals and to enable Hydrodec to pursue debt funding for these developments.

The Placing is subject to shareholder approval at a General Meeting to grant the Directors authority to issue the new

# HYDRODEC GROUP PLC

## CHAIRMAN'S STATEMENT

Ordinary Shares, and which is expected be held at 10.00 a.m. on Monday 29 June 2009 at the offices of Numis Securities Limited at The London Stock Exchange Building, 10 Paternoster Square, London EC4M 7LT.

The Company has entered into a placing agreement ("Placing Agreement") with Numis Securities Limited ("Numis"). Pursuant to the terms of the Placing Agreement, Numis, as agent for the Company, has agreed to use reasonable endeavours to procure subscribers for the new Ordinary Shares at the Placing Price. In the event that any of the new Ordinary Shares are not subscribed under the Placing, Numis will subscribe as principal for such new Ordinary Shares at the Placing Price. The Placing Agreement is conditional upon, inter alia, the resolutions being duly passed at the General Meeting and Admission becoming effective on or before 8.00 a.m. on 30 June 2009 (or such later date as the Company and Numis may agree, but in any event no later than 8.00 a.m. on 14 July 2009). The Placing Agreement contains provisions entitling Numis to terminate the Placing Agreement at any time prior to Admission in certain circumstances. If this right is exercised, the Placing will not proceed. The Placing is being fully underwritten by Numis.

Application will be made to the London Stock Exchange for the new Ordinary Shares to be admitted to trading on AIM. It is expected that Admission will become effective and that dealings in the new Ordinary Shares on AIM will commence at 8.00 a.m. on 30 June 2009.

### **Board changes**

As announced in February, the Board has considered a number of high calibre candidates to join the Board as non-executive Directors.

Further to this, the Company is delighted that Gillian Margaret Leates (51) was appointed as a non-executive Director on 12 June 2009. Gill brings with her a wealth of public market experience having served as Investment Director on the main Board of Majedie Investments PLC. Gill also worked 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.

In addition, the Company is delighted that Neil Gaskell (60) was appointed as non-executive Deputy Chairman on 18 June 2009. Mr. Gaskell 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, Mr. Gaskell was Shell Group Treasurer, responsible for all financing policies, funding and financial risk management and a Director of Shell International Limited.

Mr. Gaskell is currently a non-executive director of several companies including Wellstream Group Plc and Chairman of Aberdeen All Asia Investment Trust PLC. Mr. Gaskell 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.

As previously announced, Rodger Sargent, a non executive Director, is retiring from the Board at the AGM.

### **AGM**

An AGM to approve these accounts and other matters will be held on 28 July 2009.

### **The future**

SUPERfine™ transformer oil offers our customers sustainability with a predictable supply and competitive price, advantages which are even more compelling given the green legislation expected to be passed by President Obama. With Australia profitable, Ohio approaching capacity, plans for a second US plant developing and the Japanese opportunity continuing to progress, 2009 should see Hydrodec begin to fulfil its potential.

John Gunn

Non-executive Chairman

29 June 2009

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

The directors present their report together with the audited financial statements for the year ended 31 December 2008.

### 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 oils and creating new SUPERfine™ Oil.

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

The key business risks associated with the business is the development of SUPERfine™ Oil as an acceptable alternative to the refined product, and the key financial risk is the management of cash during this development phase for the group. Further details are set out in the Chairman's Statement.

### Results and dividends

The consolidated income statement for the year is set out on page 14. 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 2008		31 December 2007	
	Ordinary shares of 0.5p each	Share options of 0.5p each	Ordinary shares of 0.5p each	Share options of 0.5p each
J H Gunn	4,637,500	2,000,000	4,637,500	2,000,000
M D McNamara	–	6,500,000	–	5,000,000
J G Cowan	–	3,000,000	n/a	n/a
R D Sargent	1,000,000	1,000,000	1,000,000	1,500,000
J W Dickson	–	1,000,000	–	–

The exercise price and earliest and latest dates of exercise of share warrants and 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	28 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	28 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
R D Sargent	1,000,000	26.25p	22 Dec 2008	21 Dec 2016
J W Dickson	1,000,000	20.00p	1 Jan 2009	20 Sep 2017

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

The share price was 22.65p on 1 January 2008 and 27.00p on 31 December 2008, with a high and low during the year of 55.26p and 22.65p respectively.

B J Sheeran and B J Bamonte resigned as directors on 25 June 2008. G M Leates was appointed a director on 12 June 2009 and R N Gaskell on 18 June 2009.

### **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, to ensure that the suppliers are aware of the terms and to abide by the agreed terms. The holding company's creditor days at 31 December 2008 was 60 (2007: nil) days.

### **Financial risk management objectives and policies**

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

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 below. These policies have remained unchanged from previous years.

### **Currency risk**

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

Approximately 21% and 44% of the group's purchases during the year were transacted in US and Australian dollars respectively. The group does not adopt a prescribed policy to eliminate net currency exposures but does purchase US dollars and Australian dollars to hold for the purpose of settling these liabilities from time to time when the board judges the rates are favourable.

The group's financial assets and liabilities in currencies other than sterling are set out in note 19. Foreign exchange differences on retranslation of these assets and liabilities are taken to the profit and loss account of the company for monetary items and the exchange reserve for investment amounts.

### **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.

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

### **Interest rate risk**

The group finances its operations through retained profits, and with fixed term convertible financial instruments.

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

The interest rate exposure of the financial assets and liabilities of the company as at 31 December 2008 is shown in the balance sheet. The balance sheet includes trade debtors and creditors as these do not attract interest and are therefore not subject to fair value interest rate risk.

### **Credit risk**

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

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

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

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and International Financing Reporting Standards as adopted by the European Union. The parent company financial statements have been prepared in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

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

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

# HYDRODEC GROUP PLC

## REPORT OF THE DIRECTORS

### **Auditors**

Grant Thornton UK LLP offers themselves for reappointment as auditors in accordance with the section 489 of the Companies Act 2006.

BY ORDER OF THE BOARD

John Gunn

Non-executive Chairman

29 June 2009

# HYDRODEC GROUP PLC

## CORPORATE GOVERNANCE STATEMENT

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

### **Role of the Board**

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

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

### **Board processes**

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

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

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

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

### **Composition of the Board**

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

- the Board currently comprises seven 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 comprise a majority of non-executive directors,
- the Board should have enough directors to serve on various committees of the Board without overburdening the directors or making it difficult for them to fully discharge their responsibilities,
- directors appointed by the Board are subject to election by shareholders at the following annual general meeting and thereafter directors are subject to re-election at least every three years.

### **Conflict of interest**

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

# HYDRODEC GROUP PLC

## CORPORATE GOVERNANCE STATEMENT

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

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

### **Audit Committee**

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

The members of the Audit Committee for 2008 were J H Gunn (Chairman) and R D Sargent until 18 June 2009 when G M Leates and R N Gaskell joined the committee and R D Sargent retired from it.

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

The responsibilities of the Audit Committee include:

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

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

# HYDRODEC GROUP PLC

## CORPORATE GOVERNANCE STATEMENT

### Remuneration Committee

The Remuneration Committee's responsibilities include:

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

The committee for 2008 consisted of J H Gunn (Chairman) and R D Sargent until 18 June 2009 when G M Leates and R N Gaskell joined the committee and R D Sargent retired from it. The membership of the committee will be reviewed by the Board on an annual basis.

### The role of Shareholders

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

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

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

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

# HYDRODEC GROUP PLC

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

We have audited the financial statements of Hydrodec Group plc for the year ended 31 December 2008 which comprise the principal accounting policies, the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of changes in shareholders' equity and notes 1 to 24. These financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Hydrodec Group plc for the year ended 31 December 2008.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of the directors and auditor**

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

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

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Report of the Directors is consistent with the financial statements. The information given in the Report of the Directors includes that specific information presented in the Chairman's Statement that is cross referred from the principal activity, business review and business risk section of the Report of the Directors.

In addition we also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

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

### **Basis of audit opinion**

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

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

# HYDRODEC GROUP PLC

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

### **Opinion**

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2008 and of its loss for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Report of the Directors is consistent with the financial statements for the year ended 31 December 2008.

### **Emphasis of matter**

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in note 1 to the group and company financial statements concerning the company's ability to continue as a going concern.

As explained in note 1, the group has constructed the Canton, Ohio, plant and is in the process of bringing the plant to full production capacity. Currently the group is economically dependent upon the ability of this plant to produce sufficient SUPERfine oil at satisfactory margins to sustain adequate operating cash flow to meet the group's requirements. Should these conditions, along with the other matters explained in note 1 to the financial statements, not be met, then there would exist a material uncertainty 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.

GRANT THORNTON UK LLP  
REGISTERED AUDITOR AND CHARTERED ACCOUNTANTS  
LONDON  
29 June 2009

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

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

## HYDRODEC GROUP PLC

### CONSOLIDATED INCOME STATEMENT

For the year ended 31 DECEMBER 2008

	Note	2008 £'000	2007 £'000
<b>Revenue</b>	1	<b>3,791</b>	1,852
Cost of sales		<b>(1,501)</b>	(471)
Gross profit		<b>2,290</b>	1,381
Administrative expenses	2	<b>(7,394)</b>	(3,526)
<b>Operating loss</b>		<b>(5,104)</b>	(2,145)
Exceptional item – provision for investment loss	11	<b>(1,950)</b>	–
Interest payable	4	<b>(1,619)</b>	(286)
Interest receivable		<b>312</b>	150
<b>Loss on ordinary activities before taxation</b>	2	<b>(8,361)</b>	(2,281)
Tax on loss on ordinary activities	5	<b>–</b>	–
<b>Loss for the period</b>		<b>(8,361)</b>	(2,281)
<b>Loss per share – basic and diluted</b>		<b>(3.55p)</b>	(1.20p)

All transactions arise from continuing operations.

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

# HYDRODEC GROUP PLC

## CONSOLIDATED BALANCE SHEET

AT 31 DECEMBER 2008

	Note	2008 £'000	2007 £'000
<b>Non-current assets</b>			
Property, plant and equipment	7	15,826	6,751
Intangible assets	8	15,147	6,293
Other asset – prepaid royalty	9	2,555	–
		<u>33,528</u>	<u>13,044</u>
<b>Current assets</b>			
Trade and other receivables	10	1,119	748
Current asset investment	11	298	–
Inventories	12	93	156
Cash and cash equivalents		243	12,129
		<u>1,753</u>	<u>13,033</u>
<b>Current liabilities</b>			
Borrowings – bank overdraft		(172)	–
Trade and other payables	13	(2,190)	(1,194)
		<u>(2,362)</u>	<u>(1,194)</u>
<b>Net current (liabilities)/assets</b>		<b>(609)</b>	<b>11,839</b>
<b>Non-current liabilities</b>			
Borrowings	14	(4,514)	(4,051)
Deferred taxation	15	(2,077)	–
		<u>(6,591)</u>	<u>(4,051)</u>
		<u><b>26,328</b></u>	<u><b>20,832</b></u>
<b>Capital and reserves</b>			
Called up share capital	16	1,389	969
Share premium account		26,552	19,029
Equity reserve		9,411	9,574
Merger reserve		29,695	–
Treasury reserve		(26,809)	–
Employee benefit trust		(807)	(284)
Share options reserve		2,903	2,477
Profit and loss account		(19,448)	(11,087)
Foreign exchange reserve		3,442	154
<b>Total equity</b>		<u><b>26,328</b></u>	<u><b>20,832</b></u>

The financial statements were approved by the Board of Directors on 29 June 2009 and were signed on its behalf by:

**John Gunn**  
Non-executive Chairman

**J W Dickson**  
Financial Director

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

# HYDRODEC GROUP PLC

## CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 DECEMBER 2008

	2008 £'000	2007 £'000
<b>Cashflows from operating activities</b>		
Loss before tax	(8,361)	(2,281)
Net finance costs	1,307	136
Exceptional item – provision for loss on disposal	1,950	–
Amortisation	914	524
Depreciation	363	292
Loss on disposal of fixed assets	18	–
Share based payment expense	426	337
Foreign exchange movement	1,116	339
Decrease/(Increase) in inventories	63	(81)
Increase in amounts receivable	(289)	(502)
Increase in amounts payable	172	644
	<hr/>	<hr/>
<b>Net cash outflow from operating activities</b>	<b>(2,321)</b>	<b>(592)</b>
	<hr/>	<hr/>
<b>Cashflows from investing activities</b>		
Purchase of property plant and equipment	(6,934)	(3,173)
Purchase of subsidiary undertaking	(5,248)	–
Royalty prepayment	(2,685)	–
Bank interest and other income received	312	89
	<hr/>	<hr/>
	<b>(14,555)</b>	<b>(3,084)</b>
	<hr/>	<hr/>
<b>Cashflows from financing activities</b>		
Issue of new shares	7,000	2,300
Costs of share issue	(205)	(116)
Purchase of share capital	(581)	(281)
Issue of convertible loan stock	–	13,800
Costs of loan stock issue	–	(578)
Interest paid	(1,209)	(51)
Repayment of lease liabilities	(195)	(161)
	<hr/>	<hr/>
<b>Net cash inflow from financing</b>	<b>4,810</b>	<b>14,913</b>
	<hr/>	<hr/>
<b>Increase in cash and cash equivalents</b>	<b>12,066</b>	<b>11,237</b>
	<hr/>	<hr/>
<b>Movement in net cash</b>		
Cash	12,129	946
Bank overdraft	–	(54)
	<hr/>	<hr/>
Opening cash and cash equivalents	12,129	892
Cash acquired with acquisition	8	–
(Decrease)/increase in cash and cash equivalents	(12,066)	11,237
	<hr/>	<hr/>
<b>Closing cash and cash equivalents</b>	<b>71</b>	<b>12,129</b>
	<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 2008

	Share capital £000	Share premium £000	Equity reserve £000	Merger reserve £000	Foreign exchange reserve £000	Profit and loss account £000	Share option reserve £000	Treasury reserve £000	Employee benefit trust £000	Total £000
At 1 January 2006	923	16,891	–	–	(185)	(8,806)	2,140	–	–	10,963
Exchange differences	–	–	–	–	339	–	–	–	–	339
Loss for the period	–	–	–	–	–	(2,281)	–	–	–	(2,281)
Share-based payment	–	–	–	–	–	–	337	–	–	337
Issue of shares	46	2,254	–	–	–	–	–	–	–	2,300
Issue of convertible loan	–	–	9,993	–	–	–	–	–	–	9,993
Issue costs	–	(116)	(419)	–	–	–	–	–	–	(535)
Purchase of shares	–	–	–	–	–	–	–	–	(284)	(284)
<b>At 31 December 2007</b>	<b>969</b>	<b>19,029</b>	<b>9,574</b>	<b>–</b>	<b>154</b>	<b>(11,087)</b>	<b>2,477</b>	<b>–</b>	<b>(284)</b>	<b>20,832</b>
Exchange differences	–	–	–	–	3,288	–	–	–	–	3,288
Loss for the period	–	–	–	–	–	(8,361)	–	–	–	(8,361)
Share-based payment	–	–	–	–	–	–	426	–	–	426
Issue of shares	102	7,489	–	–	–	–	–	(649)	58	7,000
Acquisition (note 20)	312	–	–	29,695	–	–	–	–	–	30,007
Issue costs	–	(205)	–	–	–	–	–	–	–	(205)
Purchase of shares	–	–	–	–	–	–	–	–	(581)	(581)
Acquisition (note 20)	–	–	–	–	–	–	–	(26,160)	–	(26,160)
Conversion of loan stock	6	239	(163)	–	–	–	–	–	–	82
<b>At 31 December 2008</b>	<b>1,389</b>	<b>26,552</b>	<b>9,411</b>	<b>29,695</b>	<b>3,442</b>	<b>(19,448)</b>	<b>2,903</b>	<b>(26,809)</b>	<b>(807)</b>	<b>26,328</b>

Descriptions 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 CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 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 oils and creating new SUPERfine™ Oil. Hydrodec Group plc is the group's ultimate parent company. It is incorporated and domiciled in England & Wales and situated at 6th Floor, 80 Cannon Street, London. The group's shares are listed on the Alternative Investment Market of the London Stock Exchange.

#### **Basis of preparation**

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

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

#### **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.

The group has constructed the Canton, Ohio, plant and is in the process of bringing the plant to full production capacity. Currently, the group is economically dependent upon the ability of this plant to produce sufficient SUPERfine oil at satisfactory margins to sustain adequate cash flow to meet the group's requirements. The Directors are satisfied that at current margins and if production continues at the levels it has over the last 4 weeks, and grows as forecast (based on secured agreements for 100% plant capacity for both sales and purchases) the Group's operating cash flow requirements will be met. However, margins are affected by, amongst other things, the world price for oil, about which there is material uncertainty, and which is beyond the control of the Directors.

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.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### IFRS standards and interpretations not yet adopted

The following new standards and interpretations, which are yet to become mandatory have not been applied to the group's 2008 financial statements.

Standard or Interpretation		Effective for reporting period starting on or after
IFRS1 (revised)	Presentation of Financial Statements	1 January 2009
IFRS2 (revised)	Amendment to IFRS 2 Share-based Payment-Vesting Conditions and Cancellations	1 January 2009
IFRS3 (revised)	Business Combinations (Revised 2008)	1 July 2009
IFRS7 (revised)	Financial Instruments: Disclosures	1 January 2009
IAS1	Presentation of Financial Statements (revised 2007)	1 January 2009
IAS23	Borrowing costs (revised 2007)	1 January 2009
IAS27	Consolidated and Separate Financial Statements (Revised 2008)	1 July 2009
IAS32	Amendment to IAS32 Financial Instruments: Presentation	1 January 2009
IAS39	Amendment to IAS39 Financial Instruments: Recognition and Measurement -	1 January 2009
IFRIC9	Reassessment of Embedded Derivatives	30 June 2009
IFRIC13	Customer Loyalty Programmes	1 January 2008
IFRIC15	Agreements for the Construction of Real Estate	1 January 2009
IFRIC16	Hedges of a Net Investment in a Foreign Operation	1 October 2009
IFRIC17	Distributions of Non-cash Assets to Owners	1 July 2009
IFRIC18	Transfers of Assets from Customers	1 July 2009

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. IAS1 (revised) will affect the presentation of the results. IFRS 8 Operating Segments has been adopted early.

### Basis of consolidation

The group financial statements consolidate those of the company and its subsidiary undertakings drawn up to 31 December 2008. 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 balance sheet 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 relates to the acquisition of Virotec International Plc.

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 income statement in the period in which it arises.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### **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 expressed in sterling, which is the functional currency of the company, and presentation currency for the consolidated financial statements.

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All differences are taken to the income statement with the exception of differences on 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 income statement. Tax charges and credit attributable to exchange differences on borrowings are also dealt with in equity.

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

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the 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.

### **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 are 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.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

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 and trademarks**

All costs incurred in establishing and or maintaining patents and trademarks 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 up to the financial close of a project do not meet the criteria and 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, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets, excluding development costs, created within the business are not capitalised and expenditure is charged against profits in the year in which it is incurred.

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

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

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### **Impairment of tangible and intangible assets excluding goodwill**

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

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

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

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

### **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 CONSOLIDATED FINANCIAL STATEMENTS**

For the year ended 31 DECEMBER 2008

#### **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 and carried at fair value amount 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. Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

#### **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 CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### **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 note 1, management has not been required to make any judgements that have a significant effect on the amounts recognised in the financial statements (apart from those involving estimations, which are dealt with below).

### **Key sources of estimation uncertainty**

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

### **Amortisation of Intangible Assets**

The intangible assets carried forward relate to intellectual property acquired by the group in 2004, and through the acquisition of Virotec International plc 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.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### **Convertible loan notes**

The fair value of the loan notes is lower than the net proceeds. Management have applied their judgement 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 20).

Risks relating to these estimates are set out in the forecasts section of this note.

### **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).

### **Amortisation of Intangible Assets**

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### **Convertible loan notes**

The fair value of the loan notes is lower than the net proceeds. Management have applied their judgement 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).

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## HYDRODEC GROUP PLC

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

#### 2 REVENUE AND OPERATING LOSS

Revenue, profits and assets for both years are wholly attributable to the Group's sole activity, the treatment of used transformer oil and the sale of SUPERfine oil, which are deemed to be continuing activities. The group is managed as a single entity with geographically diverse operations

##### Primary reporting format – geographical segments

The following tables present revenue and profit and certain assets and liability information regarding the Group's geographic segments:

Year ended 31 December 2008	USA £'000	Australia £'000	Corporate £'000	Total £'000
<b>Continuing operations</b>				
Revenue	215	3,576	–	3,791
Non-current assets	11,353	8,920	12,985	33,528
Year ended 31 December 2007	USA £'000	Australia £'000	Corporate £'000	Total £'000
<b>Continuing operations</b>				
Revenue	–	1,852	–	1,852
Non-current assets	2,763	5,728	4,553	13,044

The loss on ordinary activities before taxation is stated after charging the following expenses, which, except for cost of goods sold, are all included in administrative expenses:

	2008 £'000	2007 £'000
Capital expenditure		
– property, plant and equipment	8,400	3,202
– intangible assets	9,638	–
Cost of goods sold	1,501	471
Depreciation	363	292
Amortisation	524	524
Share based payments	426	337
Fees payable to the company's auditor for the audit of the annual accounts	70	28
Fees payable to the company's auditor and its associates for other services:		
– the audit of the company's subsidiaries	30	5
– tax services	15	15

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.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 3 DIRECTORS AND EMPLOYEES

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

	2008 Number	2007 Number
Operations	62	34
Corporate office	6	6
	<u>68</u>	<u>40</u>

The aggregate cost of these employees was:

	2008 £'000	2007 £'000
Wages and salaries	1,713	1,263
Payroll taxes	110	50
Share based payments	426	337
	<u>2,249</u>	<u>1,650</u>

Directors emoluments paid during the period were:

	2008 £'000	2007 £'000
Emoluments	465	319

The highest paid director received emoluments totalling £133,000 (2007: £112,000). Pension contributions for directors totalled £13,000 (2007: £nil).

Remuneration in respect of key management personnel was as follows:

	2008 £'000	2007 £'000
Emoluments	92	63
Share-based payments	125	61
	<u>217</u>	<u>124</u>

### 4 INTEREST PAYABLE

	2008 £'000	2007 £'000
Bank overdrafts	47	51
Convertible loan stock	1,572	235
	<u>1,619</u>	<u>286</u>

## HYDRODEC GROUP PLC

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

#### 5 TAX

	2008 £'000	2007 £'000
Current and total tax	—	—
Loss on ordinary activities before taxation	<b>(8,361)</b>	(2,281)
Rate of corporation tax in the United Kingdom of 28.5% (2007: 30%)	<b>(2,383)</b>	(683)
Effects of:		
Expenses not deductible for tax purposes	<b>904</b>	259
Tax losses not recognised	<b>1,479</b>	424
	—	—

A deferred tax asset of approximately £2,679,000 (2007: £1,200,000) is not recognised due to the uncertainty of future taxable profits.

#### 6 LOSS PER SHARE

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

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

2008 Number of shares	2007 Number of Shares
<b>201,866,635</b>	189,725,620

In 2007 and 2008, 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 treasury and EBT shares controlled by the group.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 7 PROPERTY, PLANT AND EQUIPMENT

	Plant and Equipment £'000
<b>Cost</b>	
At 1 January 2007	3,925
Additions	3,202
	<hr/>
At 31 December 2007	7,127
Change in exchange rates	1,476
Additions	8,400
Disposals	(45)
	<hr/>
At 31 December 2008	<b>16,958</b>
	<hr/> <hr/>
<b>Accumulated depreciation</b>	
At 1 January 2007	84
Depreciation charge for the year	292
	<hr/>
At 31 December 2007	376
Change in exchange rates	420
Depreciation charge for the year	363
Disposals	(27)
	<hr/>
At 31 December 2008	<b>1,132</b>
	<hr/> <hr/>
<b>Carrying amount</b>	
At 31 December 2008	<b>15,826</b>
	<hr/> <hr/>
At 31 December 2007	6,751
	<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 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 £505,000 (2007: £429,000) in respect of assets held under finance leases.

## HYDRODEC GROUP PLC

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

#### 8 INTANGIBLE ASSETS

	Hydrodec Technology £'000	Goodwill £'000	Total £'000
<b>Cost</b>			
At 1 January 2007 and 1 January 2008	7,866	2,003	9,869
Additions Virotec acquisition (note 20)	7,561	2,077	9,638
At 31 December 2008	<b>15,427</b>	<b>4,080</b>	<b>19,507</b>
<b>Accumulated amortisation and impairment</b>			
At 1 January 2007	1,049	2,003	3,052
Provided in year	524	–	524
At 1 January 2008	1,573	2,003	3,576
Provided in the year	784	–	784
At 31 December 2008	<b>2,357</b>	<b>2,003</b>	<b>4,360</b>
<b>Carrying amount</b>			
At 31 December 2008	<b>13,070</b>	<b>2,077</b>	<b>15,147</b>
At 31 December 2007	6,293	–	6,293

The Hydrodec Technology is being amortised over its anticipated useful life of 15 years. The intangible asset carried forward relates to intellectual property acquired by the group in 2004. The intellectual property consists of know how and trade secrets relating to the Technology, some of which is covered in a patent. It is management's view that the useful life of the intellectual property will extend far beyond the life of the patent (approximately 10 years) and for the purposes of calculating the period over which the costs will be amortised it has been estimated that the minimum useful life of the Technology is 15 years. At 31 December 2008, the unamortised life of the asset was 12 years.

Goodwill relates to the acquisition of Virotec International Plc.

## HYDRODEC GROUP PLC

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

#### 9 OTHER NON-CURRENT ASSETS

	Pre-paid royalty £'000
<b>Cost</b>	
At 31 December 2007	–
Addition	2,685
	<hr/>
At 31 December 2008	<b>2,685</b>
	<hr/>
<b>Accumulated depreciation</b>	
At 31 December 2007	–
Expensed during the year	130
	<hr/>
At 31 December 2008	<b>130</b>
	<hr/>
<b>Carrying amount</b>	
At 31 December 2008	<b>2,555</b>
	<hr/> <hr/>
At 31 December 2007	–
	<hr/> <hr/>

The pre-paid royalty is recorded at cost 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.

#### 10 TRADE AND OTHER RECEIVABLES

	2008 £'000	2007 £'000
Trade receivables	<b>570</b>	499
Other receivables	<b>176</b>	110
Other taxation and social security	<b>251</b>	20
Prepayments and accrued income	<b>122</b>	119
	<hr/>	<hr/>
	<b>1,119</b>	<b>748</b>
	<hr/> <hr/>	<hr/> <hr/>

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:

	2008 £'000	2007 £'000
Sterling	<b>251</b>	–
Australian dollars	<b>586</b>	748
United States dollars	<b>282</b>	–
	<hr/>	<hr/>
	<b>1,119</b>	<b>748</b>
	<hr/> <hr/>	<hr/> <hr/>

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 11 CURRENT ASSET INVESTMENT

	2008 £'000	2007 £'000
Investment	<u>298</u>	<u>—</u>

The investment in Molecra Group Limited has been designated as available for sale and valued at fair value through the income statement, being the market value of the shares. It was acquired on 25 June 2008 for £2.25m as part of the acquisition of Virotec International plc (note 20) and written down to its fair value at 31 December 2008. On 5 February 2009, the investment was sold at its carrying amount. It has been treated as a non-operating asset disposal.

### 12 INVENTORY

	2008 £'000	2007 £'000
Finished goods at cost	<u>93</u>	<u>156</u>

### 13 TRADE AND OTHER PAYABLES

	2008 £'000	2007 £'000
Trade payables	1,059	790
Finance lease obligations	148	128
Other taxation and social security	357	38
Accruals and deferred income	626	238
	<u>2,190</u>	<u>1,194</u>

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

### 14 NON-CURRENT LIABILITIES - BORROWINGS

	2008 £'000	2007 £'000
Convertible loan stock	4,046	3,718
Finance lease liabilities due within five years	468	333
	<u>4,514</u>	<u>4,051</u>

## HYDRODEC GROUP PLC

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

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 19p per share at any time between April 2008 and November 2012. Those elements not converted into shares by this date are repayable in one amount in August 2014. Interest is charged at a fixed rate of 8% per annum on the value of the unconverted loan.

	2008 £'000	2007 £'000
Face value of convertible bond issued	13,555	13,800
Equity component	<u>(9,830)</u>	<u>(9,993)</u>
Liability component	3,725	3,807
Interest expense	1,572	235
Interest payable	<u>(1,172)</u>	<u>(165)</u>
Liability component at 31 December 2008	4,125	3,877
Unamortised issue costs	<u>(79)</u>	<u>(159)</u>
Net liability component at 31 December 2008	<u><u>4,046</u></u>	<u><u>3,718</u></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 £245,000 were converted into share capital of the company.

#### 15 DEFERRED TAXATION

	£'000
At 31 December 2007	–
Fair value adjustment on acquisition (note 20)	<u>2,077</u>
At 31 December 2008	<u><u>2,077</u></u>

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 16 SHARE CAPITAL

	2008 £'000	2007 £'000
Authorised 800,000,000 ordinary shares of 0.5p each	<b>4,000</b>	4,000
	<b>Number of shares</b>	<b>Number of shares</b>
<b>Issued and fully paid – ordinary shares of 0.5 pence each</b>		
At the beginning of the year	<b>193,845,400</b>	184,645,400
Issued on acquisition (note 20)	<b>62,515,894</b>	–
Treasury stock issued	<b>2,173,335</b>	–
Conversion of loan note	<b>1,289,472</b>	–
Issued for cash	<b>18,000,000</b>	9,200,000
At the end of the year	<b>277,824,101</b>	193,845,400
	<b>£'000</b>	<b>£'000</b>
At the beginning of the year	<b>969</b>	923
Issued on acquisition (note 20)	<b>312</b>	–
Conversion of loan note	<b>6</b>	–
Issued for cash	<b>102</b>	46
At the end of the year	<b>1,389</b>	969

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
21 April 2008	<b>10,000,000</b>	50	5,000
26 November 2008	<b>8,000,000</b>	25	2,000
25 June 2008	<b>62,515,894</b>	48	–
25 June 2008	<b>2,173,335</b>	48	–
30 May 2008	<b>184,210</b>	19	–
12 September 2008	<b>52,631</b>	19	–
14 October 2008	<b>1,052,631</b>	19	–

In January 2008, the Employee Benefit Trust purchased 2,000,000 of the company's shares at a price of 28.75 p each which are held as treasury shares pending distribution to qualifying employees at the discretion of the trustees.

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 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 (note 20).

The Employee Benefit Trust represents the value of treasury shares held by the group 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 IFRS2 in respect of share based payments.

### 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 exercisable at a price equal to the average quoted market price of the Company's shares on the date of grant. The vesting period is over a variable period up to 10 years. No options were forfeited in the year and 13,700,000 options were exercisable at 31 December 2008 at a weighted average exercise price of 17p per share.

	2008		2007	
	Number	Weighted average exercise price	Number	Weighted average exercise price
At the beginning of the year	21,700,000	18.1p	18,700,000	17.6p
Issued in the year	3,500,000	33.3p	3,000,000	19.2p
Forfeited during the year	–	–	–	–
Exercised during the year	(500,000)	11.5p	–	–
<b>At the end of the year</b>	<b>24,700,000</b>	<b>20.4p</b>	<b>21,700,000</b>	<b>18.1p</b>

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

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:

	2008	2007
Weighted average share price	<b>21.0p</b>	21.0p
Weighted average exercise price	<b>20.4p</b>	18.1p
Expected volatility	<b>97%</b>	86%
Expected life	<b>8.0yrs</b>	9.0yrs
Risk free rate	<b>5.2%</b>	5.2%
Expected dividend yield	<b>0.6%</b>	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 5.0% 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 are not expected to give rise to a material adjustment to the reported results for either 2008 or 2007.

#### 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 £570,000 (2007: £499,000).

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

# HYDRODEC GROUP PLC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### Currency risk

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

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

	US dollars		Australian dollars	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000
Inventory	40	–	81	156
Trade and other receivables	282	–	587	687
Cash and cash equivalents	70	3,188	4	114
Borrowings	–	–	(172)	(461)
Trade and other payables	(962)	(392)	(385)	(438)

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 British Pound to USD and AUD 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.

	US dollars		Australian dollars	
	2008	2007	2008	2007
Currency fluctuation	10%	10%	10%	10%

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

	2008 £'000		2007 £'000	
	2008 USD	2008 AUD	2007 USD	2007 AUD
Net result for the year	171	56	8	172
Equity	217	51	8	521

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

	2008 £'000		2007 £'000	
	2008 USD	2008 AUD	2007 USD	2007 AUD
Net result for the year	(171)	(56)	(8)	(190)
Equity	(217)	(510)	(8)	(521)

Exposure to foreign exchange rates varied 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 CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

### 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 ACQUISITIONS

On 25 June 2008 the group acquired 100% of the share capital of Virotec International plc for a consideration of £35,255,000, including costs, satisfied by the issue of 62,515,894 ordinary shares at 48p, the mid market price at acquisition, and £3,457,000 in cash. Goodwill arising on the acquisition of £2,077,000 has been accounted for by the acquisition method of accounting.

The assets and liabilities acquired were as follows:

	Book value	Adjustment	Provisional fair value
	£'000	£'000	£'000
<b>Non-current assets</b>			
Intangible assets	–	7,561	7,561
Treasury stock	–	26,160	26,160
<b>Current assets</b>			
Trade receivables	82	–	82
Investments	5,180	(2,932)	2,248
Bank and cash	8	–	8
<b>Creditors</b>			
Trade creditors	(212)	(592)	(804)
Deferred tax	–	(2,077)	(2,077)
Net assets	<u>5,058</u>	<u>28,120</u>	<u>33,178</u>
Purchased goodwill capitalised			<u>2,077</u>
			<u>35,255</u>
Satisfied by:			
Issue of shares			30,007
Cash			3,457
Acquisition costs			1,243
Deferred consideration			548
			<u>35,255</u>

The treasury shares comprise 54.5 million shares in the Hydrodec Group, which had been held at cost by Virotec International plc.

Intangible assets acquired is the fair value of the future cash flows of the royalty payable from Hydrodec Group plc to Virotec International plc.

Deferred tax has been provided on all fair value adjustments and purchased intangible assets where a future tax benefit will be obtained.

## HYDRODEC GROUP PLC

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 DECEMBER 2008

The loss after taxation of Virotec International plc for the period from 1 January 2008, the beginning of its financial year to the date of acquisition was £6,071,000. The loss after taxation for the year ended 31 December 2007 of acquisition's previous financial year was AUD 13,369,000.

The subsidiary undertakings acquired during the year made the following contribution to, and utilisation of, group cash flow.

	2008 £'000
Net cash outflow from operating activities	(256)
Financing – loans from group	259
Increase in cash	3

Analysis of net inflow of cash in respect of the purchase of the subsidiary undertakings:

	2008 £'000
Cash at bank and in hand acquired	
Increase in cash	8
Cash	3
	<hr/>
	11
	<hr/> <hr/>

#### 21 CAPITAL COMMITMENTS

At 31 December 2008, the group had no capital commitments (2007: £4,586,000).

#### 22 CONTINGENT LIABILITIES

There were no contingent liabilities at 31 December 2008 or 31 December 2007.

#### 23 RELATED PARTY TRANSACTIONS

AirTerAq, a company in which a director, M D McNamara has an interest, supplied services to the value of £111,000 during 2008 (2007: £144,000) and was owed £nil at 31 December 2008 (2007: £15,000).

#### 24 POST BALANCE SHEET EVENTS

On 23 February and 29 June 2009, the group raised additional capital of £1.9 million and £3.2 million gross through an issue of new shares respectively.

## **HYDRODEC GROUP PLC**

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

We have audited the parent company financial statements of Hydrodec Group plc for the year ended 31 December 2008 which comprise the principal accounting policies, the balance sheet and notes 1 to 32. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of Hydrodec Group plc for the year ended 31 December 2008.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

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

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

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

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements we also report to you have been properly prepared in accordance with the Companies Act 1985 whether in our opinion the information given in the Report of the Directors is consistent with the financial statements.

In addition we also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

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

#### **Basis of audit opinion**

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

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

## HYDRODEC GROUP PLC

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

#### **Opinion**

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2008;
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Report of the Directors is consistent with the financial statements.

#### **Emphasis of matter**

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in note 1 to the group and company financial statements concerning the company's ability to continue as a going concern.

As explained in note 1, the group has constructed the Canton, Ohio, plant and is in the process of bringing the plant to full production capacity. Currently the group is economically dependent upon the ability of this plant to produce sufficient SUPERfine oil at satisfactory margins to sustain adequate operating cash flow to meet the group's requirements. Should these conditions, along with the other matters explained in note 1 to the financial statements not be met, then there would exist a material uncertainty 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.

GRANT THORNTON UK LLP  
REGISTERED AUDITOR AND CHARTERED ACCOUNTANTS  
LONDON  
29 JUNE 2009

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

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

**HYDRODEC GROUP PLC**  
**COMPANY BALANCE SHEET**  
At 31 DECEMBER 2008

	Note	2008 £'000	2007 £'000
<b>Fixed assets</b>			
Investments	28	<u>30,037</u>	<u>8,232</u>
<b>Current assets</b>			
Debtors	29	977	346
Amounts due from subsidiary undertakings		22,558	14,462
Cash at bank		<u>156</u>	<u>8,827</u>
		23,691	23,635
<b>Creditors: amounts falling due within one year</b>	30	<u>(845)</u>	<u>(236)</u>
<b>Net current assets</b>		<u>22,846</u>	<u>23,399</u>
<b>Total assets less current liabilities</b>		52,883	31,631
<b>Creditors: amounts falling due after more than one year</b>	31	<u>(4,046)</u>	<u>(3,718)</u>
		<u>48,837</u>	<u>27,913</u>
<b>Capital and reserves</b>			
Called up share capital	16	1,389	969
Share premium account		56,247	19,030
Equity reserve		9,411	9,574
Treasury reserve	32	(649)	–
Profit and loss account		<u>(17,561)</u>	<u>(1,660)</u>
Shareholders' funds		<u>48,837</u>	<u>27,913</u>

The financial statements were approved by the Board of Directors on 29 June 2009 and were signed on its behalf by:

**John Gunn**  
Non-executive Chairman

**J W Dickson**  
Financial Director

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

# **HYDRODEC GROUP PLC**

## **NOTES TO THE COMPANY BALANCE SHEET**

At 31 DECEMBER 2008

### **25 SIGNIFICANT ACCOUNTING POLICIES**

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

The group has constructed the Canton, Ohio, plant and is in the process of bringing the plant to full production capacity. Currently, the group is economically dependent upon the ability of this plant to produce sufficient SUPERfine™ oil at satisfactory margins to sustain adequate cash flow to meet the group's requirements.

The Directors are satisfied that at current margins and if production continue at the levels it has over the last 4 weeks, and grows as forecast (based on secured agreements for 100% plant capacity for both sales and purchases) the Group's operating cash flow requirements will be met. However, margins are affected by amongst other things, the world price for oil, around which there is material uncertainty, and which is beyond the control of the Directors.

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.

#### **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.

# HYDRODEC GROUP PLC

## NOTES TO THE COMPANY BALANCE SHEET

At 31 DECEMBER 2008

### 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:

	2008 Number	2007 Number
Corporate office	<u>6</u>	<u>6</u>

Staff costs during the year were as follows:

	2008 £'000	2007 £'000
Wages and salaries	465	837
Social security costs	7	50
Other pension costs	426	337
	<u>898</u>	<u>1,224</u>

Directors emoluments paid during the period were:

	2008 £'000	2007 £'000
Emoluments	<u>465</u>	<u>200</u>

The highest paid director received emoluments totalling £133,000 (2007: £112,000). Pension contributions for directors totalled £13,000 (2007: £nil).

	2008 £	2007 £
Emoluments	465	200
Pension contributions to money purchase pension schemes	<u>13</u>	<u>–</u>

### 27 LOSS ATTRIBUTABLE TO THE SHAREHOLDERS OF THE COMPANY

The company is an investment holding company. It receives management charges from subsidiaries and bank interest. As permitted by section 230 of the Companies Act 1985, 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 £15,600,000 (2007: £433,000).

# HYDRODEC GROUP PLC

## NOTES TO THE COMPANY BALANCE SHEET

At 31 DECEMBER 2008

### 28 INVESTMENTS

	Shares in subsidiary undertakings £'000	Loans to Subsidiary undertakings £'000	Total £'000
<b>Cost</b>			
At 1 January 2008	7,621	611	8,232
Additions	35,255	–	35,255
	<hr/>	<hr/>	<hr/>
At 31 December 2008	<b>42,876</b>	<b>611</b>	<b>43,487</b>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
<b>Provisions</b>			
At 1 January 2008	–	–	–
Provided in year	13,450	–	13,450
	<hr/>	<hr/>	<hr/>
At 31 December 2008	<b>13,450</b>	<b>–</b>	<b>13,450</b>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
<b>Net book values</b>			
At 31 December 2008	<b>29,426</b>	<b>611</b>	<b>30,037</b>
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
At 31 December 2007	7,621	611	8,232
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

The subsidiary undertakings at 31 December 2008 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 America Holdings Inc	USA	100%	Holding company
Hydrodec North America LLP**	USA	100%	Oil treatment Services
Virotec International Ltd	UK	100%	Holding Company
Virotec International Pty Ltd***	Australia	100%	Investment Company

\* Held through Hydrodec Development Corporation Pty Limited

\*\* Held through Hydrodec North American Holdings Inc

\*\*\* Held through Virotec International Limited

### 29 DEBTORS

	2008 £'000	2007 £'000
Other debtors	169	345
Employee benefit trust	808	–
	<hr/>	<hr/>
	<b>977</b>	<b>345</b>
	<hr/> <hr/>	<hr/> <hr/>

## HYDRODEC GROUP PLC

### NOTES TO THE COMPANY BALANCE SHEET

At 31 DECEMBER 2008

#### 30 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2008 £'000	2007 £'000
Trade creditors	12	–
Other creditors	75	–
Accruals	422	236
Amounts due from subsidiary undertakings	336	–
	<u>845</u>	<u>236</u>

#### 31 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2008 £'000	2007 £'000
Convertible loan stock	<u>4,046</u>	<u>3,718</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 19p per share at any time between April 2008 and November 2012. Those elements not converted into shares by this date are repayable in one amount in August 2014. 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 £245,000 were converted into share capital of the company.

	2008 £'000	2007 £'000
Face value of convertible bond issued	13,555	13,800
Equity component	<u>(9,830)</u>	<u>(9,993)</u>
Liability component	3,725	3,807
Interest expense	1,572	235
Interest payable	<u>(1,172)</u>	<u>(165)</u>
Liability component at 31 December 2008	4,125	3,877
Unamortised issue costs	<u>(79)</u>	<u>(159)</u>
	<u>4,046</u>	<u>3,718</u>

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.

## HYDRODEC GROUP PLC

### NOTES TO THE COMPANY BALANCE SHEET

At 31 DECEMBER 2008

#### 32 RESERVES

	Treasury reserve £'000	Profit and loss account £'000
At 1 January 2008	–	(1,661)
Issue of shares	(649)	–
Loss for the financial year	–	(15,900)
At 31 December 2008	<u>(649)</u>	<u>(17,561)</u>