Surface Transforms plc

Registered number 3769702

Annual Report and Financial Statements

for the year ended 31 May 2011

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Contents

Highlights

- Revenue increased by 7.3% to £863,439 (2010: £804,800).
- Losses after taxation £870,961 (2010: £536,019).
- Cash position as at 31 May 2011 of £615,145 (2010: £414,513).
- Order book plus contracted sales for delivery by 31 May 2012 of £568,000 (2010: £521,996).
- Fundraising of £1.2 million net of expenses, in November 2010 at 17 pence per share.
- In March 2011 the Company entered into a forward contractual supply agreement with one of its main clients, Mov'IT International. The contract expires on 31 December 2014 and provides for the sale of ceramic brake discs with a minimum value of approximately £2.7m (€3.1 million) over the contract term.
- During October 2010, the Company signed a Development Agreement with a major US manufacturer of wheels and brake systems for the aircraft industry.

Chairman's statement

In the year ended 31 May 2011 the Company achieved a 7.3% increase in revenues to £863,439 (2010: £804,800). These revenue levels although higher than last year were lower than expected or budgeted. Losses before taxation for the period were higher at £973,888 (2010: £747,091). Losses after taxation for the period were also higher at £870,961 (2010: £536,019).

Highlights for the 12 month period were:

- During October 2010, the Company signed a Development Agreement with a major US manufacturer of wheels and brake systems for the aircraft industry. Over the past 24 months, the Company has undertaken a series of brake disc trials with this client and this agreement formalises the business relationship between the two companies. This is initially a development agreement and due to the nature of projects of this type, it is difficult to predict timetables and success thresholds. Nevertheless, both parties are focused on completing the development test programmes and, should the Company's carbon ceramic product pass all test criteria, the business will move to commercial supply.
- During March 2011 the Company entered into a new supply agreement with one of its main clients, Mov'IT International. This contract expires on 31 December 2014 and provides for the sale of ceramic brake discs with a minimum value of approximately £2.7 million (€3.1 million) over the contract term.
- Development costs were substantially higher than the previous year due to increased costs associated with new testing work which was not funded by the customer, but which was necessary for automotive and aircraft brake evaluation programmes. The Board anticipates that such costs will be considerably reduced in the coming financial year.
- In March 2011 we commenced a new level of commercial partnership with Alcon Components Ltd, an existing client, for the supply of carbon ceramic brake discs for selected ranges of high performance cars for both road and track use. The first application is the supply of ceramic brake discs for the Nissan GTR for their Asian markets and distributors. Alcon is one of the premier UK based brake systems suppliers to both the automotive OEM and aftermarket.
- During November 2010, the Company raised £1.19 million, net of expenses, by way of a Placing and Open Offer to shareholders. The new ordinary shares were issued at 17 pence per share. The additional funds have and will be used to increase production capacity and tooling and reduce the direct cost of manufacturing carbon ceramic discs as well as to support ongoing working capital.

FINANCIAL REVIEW

In the year ended 31 May 2011 revenues were £863,439 (2010: £804,800). This 7.3% increase in revenues, although lower than expected, was achieved with no sales of discs to the US brake system supplier for the development of a next generation military vehicle. Such sales, at approximately £250,000, were significant during the financial year ended 31 May 2010. These revenues have been replaced by sales to commercial automotive clients. The Board does not anticipate selling any further discs to the US military development project until late 2012, by which time we hope that the brake trials will have been completed satisfactorily. It is our understanding that our ceramic discs have performed well to date during testing; there have been no breakages or failures, which is very encouraging but consequently there have been no replacement disc sales.

The order book and contracted sales for the year ending 31 May 2012 amounts to £568,000 (31 May 2010: £521,996). The contracted sales, expected to be in excess of £280,000, relate to a three year, forward contractual supply agreement the Company entered into in March 2011 with one of its main clients, Mov'IT International.

Losses after taxation were £870,961 (2010: £536,019). There are two main reasons for the increased losses: (i) an increase in research and development costs which was not funded by clients. These were incurred to evaluate brake discs for a number of new car platforms and for an aircraft brake and (ii) an unexpected reduction in R&D tax credits of £108,000. Hitherto, annual tax credits of approximately £200,000 have been received by the Company to cover R&D activity.

Looking ahead our R&D tax credit advisers, Baker Tilly, expect tax credits to continue to be received by the Company and within a range of £150,000 to £170,000. Research costs, not funded by customers, are expected to fall back sharply to more historic levels in the financial year ending 31 May 2012.

The Company has taken additional steps to reduce its cost base and savings of approximately £170,000 p.a for the year commencing 1 June 2011 should be achieved.

Loss per share was 3.09 pence (2010: loss 2.33 pence).

The Company had a cash balance of £615,145 at 31 May 2011 (31 May 2010: £414,513).

Shareholders funds were £1,489,607 (31 May 2010: £1,079,133).

DIRECTORS AND STAFF

Professor David Clark, one of the four founders of the Company in 1992, will not be seeking re election as a non executive director at the AGM in October this year. David is one of the UK's leading and most respected scientists in carbon fibre and carbon ceramic technology and he is an adviser to a number of institutions on this subject including the Ministry of Defence. He co-founded the Company as a spin out from ICI where he had been a director in charge of Development and New Technologies. We shall miss his regular counsel at the Board but we shall continue to have access to his advice.

Dr. Geoff Gould has reached retirement age and has recently reduced his executive status from full time to part time and he intends to retire fully this year. Geoff is responsible for sales to the aircraft brake and rocket motor markets and joined in 2001 from Honeywell where he was a senior executive in the carbon fibre business. I am pleased, however, that we shall continue to have access to his experience and counsel on a consultancy basis whenever required going forward.

With the retirement of David and Geoff during 2011, the Company is very fortunate that David Bundred has today agreed to join the Board as a Non Executive director. David is a chartered engineer and has had a senior and very successful career at some of the UK's leading industrial businesses. His commercial experience is highly relevant to the aircraft and automotive brake markets that the Company addresses. During a 24 year career at Lucas his appointments included General Manager of the Brake Controls and the Truck Brakes Divisions and between 1993-1999 he was a Divisional Managing Director and latterly Chief Operating Officer of Lucas Aerospace. Until he retired in 2005, he was CEO of TMD Friction Group GmbH in Germany, a large, global supplier of brake pads to the automobile industry.

I would like to thank all my colleagues, management and staff alike, for their hard work and dedication over the past year. It is a credit to all staff that the Company has again maintained its ISO 9001 accreditation.

OUTLOOK

The 2011 financial year was disappointing for management as we had expected revenues to be much higher together with lower development costs. Nevertheless, the sales achievement should not be underestimated given difficult market conditions generally, but also as the growth was achieved in spite of there being no sales to the next generation military project in the USA. Surface Transforms is one of only two worldwide suppliers of ceramic brake discs and, in light of broader demand for such brake systems, we expect further expansion of our business despite the difficulties in forecasting.

We have consistently strived to reduce our sales break even levels with lower overheads, increased productivity and programmes to reduce unit product costs. Current estimates indicate that cash breakeven occurs at approximately £1.5 million of revenues given the current product mix.

I said last year that the challenges facing management had moved from technology based issues to operating matters relating to the management of working capital, production and the investment in additional process capacity to accommodate the expected growth in revenues. These challenges continue and we have commenced on process capacity expansion as a priority with detailed discussions currently ongoing with selected suppliers.

Looking ahead to May 2012, although the euro-zone economy appears fraught with challenges we do not expect that the banking and sovereign debt problems will materially affect our automotive clients in Sweden, Germany and the European racing industry. The deficit reduction programmes of the main European economies have slowed defence spending and so our rocket motor development revenues are expected to remain subdued.

We anticipate lower losses for both the first half and also for the full year compared to 2010/11. We are focussed on the business achieving cash breakeven as soon as possible and believe that increasing revenues from our existing customer base will take us to that target. The high performance and race automotive sector in Europe is expected to dominate our revenue profile in 2012 and there is the possibility that the supply of ceramic brake components to the aircraft sector in the USA may commence in late calendar year 2012.

Kevin D'Silva
Chairman

4 August 2011

Chief executive's report

The Company expected higher revenues from the automotive market in terms of development programmes and increased market demand, and to maintain development sales revenue from its aerospace and defence components clients. It is always difficult predicting the adoption curve of new technologies and the anticipated demand from the automotive market, although growing, was slower than expected and the revenues from the aerospace and defence markets below expectations.

AUTOMOTIVE – HIGH PERFORMANCE AND RACE CAR BRAKE SYSTEMS

The revenues from our automotive clients increased significantly in the year, more than enough to compensate for the previous year's sales of carbon ceramic product to the US brake system supplier for the development of the next generation military vehicle (sales in excess of £250,000 which was non-recurring), and for the fall in aerospace and defence component development revenues. Whilst total sales grew by 7.3%, this was below the Board's expectations.

Feedback from the US brake system supplier for the development of the next generation military vehicle has been very positive with the Company's products performing well. There have been no issues to date, which is very encouraging.

Revenues with Koenigsegg and the North American aftermarket have continued and the Company's revenue growth has been strong, especially in sales to the European aftermarket with our European distribution partner Mov'IT. The Company was pleased to sign a new supply agreement with Mov'IT in March 2011. The new agreement covers the period to 31 December 2014 and provides for minimum sales to Mov'IT of approximately £2.7 million (€3.1 million) over the term.

Secondly, revenues in the racing market also grew with the Company's products being recognised as world class by our customer, a leading global brake system supplier.

The Company is focused on winning new business and in early 2011 began a commercial partnership with Alcon Components Ltd, a leading UK based performance brake system supplier to both automotive OEM's and the aftermarket. The first commercial application to come out of the partnership is a new ceramic brake upgrade kit for the Nissan GTR for Alcon's Asian market. The Company believes as the partnership develops, further systems will be produced and commercialised.

Alcon Components Ltd is also a member of the Company's collaborative R&D project, funded by the Technology Strategy Board. The project continues to progress on track with promising results which are of interest to both the automotive partners Alcon and Bentley Motor Cars and rail partner Faiveley Transport.

AEROSPACE AND DEFENCE BRAKE DISCS AND COMPONENTS

The Company has worked on a number of development programs in these markets. The development with a US brake system supplier for a carbon ceramic brake disc continues with the signing of a development agreement in October 2010. Our client's initial focus had been on the delivery of a new technology solution for one particular application, although they believe the technology can be applied to other applications which they currently supply and have therefore broadened the scope of the development. To support the development the customer has agreed to fund the future development activities and the first of such orders has now been received. Both companies are committed to completing the technical development and achieving a commercial solution as quickly as possible.

Surface Transforms carbon ceramic technology is uniquely positioned to deliver affordable, high performance (in terms of extended life and reduced mass) rocket components.

We have successfully completed the final year of a three year development programme with MBDA, a world leading missile manufacturer jointly owned by BAE Systems, EADS and Finmecanica and sponsored by the UK and French Ministries of Defence. The objective of the programme was to evaluate our proprietary carbon ceramic technology for its use in rocket component applications. The development work delivered very promising results in terms of material characteristic and cost to manufacture, confirming its potential use as affordable, high performance rocket components. MBDA have also identified a number of potential rocket components the technology could be applied too. Similarly the development program with Microturbo, one of the world leaders in gas turbine applications for missile propulsion has delivered encouraging results during its first year of a planned two year programme.

In the current environment of government deficit reduction programmes, the effect on the MoD and its suppliers is to add a high degree of uncertainty to development funds, making the future of both of these promising programmes unclear. Consequently revenues were lower than expected this year and we anticipate this situation will remain uncertain until at least the early part of next year.

OPERATIONS

Affordability and supply capability are the key requirements for our customers. The current economic backdrop has seen significant price increases from some of the Company's suppliers. The Company is working to minimise these cost pressures both through the supply chain and within the Company's process technology, with some success. These activities, coupled with a significant increase in automotive development testing necessary for our automotive customers this year, led to much higher development costs than the Company had anticipated. Now complete, the Board is confident these costs will be greatly reduced in this new financial year.

With the growth in the automotive market expected to continue, the company has established a capacity expansion plan which will address the key bottlenecks through process improvement and additional process plant.

PEOPLE

The Company continues to have a strong and focused senior management team who have supported the business constantly during the year, showing tremendous commitment to driving the Company forward to achieving it goals.

I would like to thank all my colleagues for their dedication and hard work during the year.

Kevin Johnson
Chief Executive

4 August 2011

Directors report

The Directors present their annual report and the audited financial statements for the year ended 31 May 2011.

PRINCIPAL ACTIVITY

The principal activity of the Company during the year was the development and manufacture of carbon fibre reinforced ceramic product (CFRC) for automotive disc brake and aircraft and rocket component applications.

BUSINESS REVIEW

A review of the Company's activities during the year is provided within the financial review section of the Chairman's statement on page 3.

KEY RISKS AND UNCERTAINTIES

As in previous years the principal risk faced by the Company is considered to be the speed at which our customers and potential customers adopt the new ceramic disc technology. Indications in the automotive market are that the technology continues to be well received and is being adopted over an increasing number of vehicles. This risk is constantly assessed by monitoring the level of enquiries and orders for both the Company and industry wide. In addition the Company faces the continuing uncertainty created by the current economic climate, particularly within the automotive sector.

KEY PERFORMANCE INDICATORS

The Directors continue to monitor the business internally with a number of performance indicators: order intake, sales output, profitability and manufacturing cost of automotive discs. The Company has met its revised performance targets in each of these areas – please see Chairman's statement for more details:

- Turnover £863,439 (2010: £804,800)
- Losses after taxation £870,961 (2010: £536,019)
- Order book of £568,000 as at 31 May 2011 (2010: £521,996)

The Company produces an annual business plan and full monthly forecasts detailing sales, profitability and cash flow to help monitor business performance going forward.

FUTURE DEVELOPMENTS

In the short term, the Company aims to continue with its corporate strategy which is to exploit its technologies in carbon fibre reinforced ceramics by:

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

RESEARCH AND DEVELOPMENT

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

PROPOSED DIVIDEND AND TRANSFER TO RESERVES

The loss for the year after taxation amounted to £870,961 (2010: £536,019). The Directors do not recommend the payment of a dividend.

POLICY AND PRACTICE ON PAYMENT OF PAYABLES

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

At the year end, there were 55 days (2010: 64 days) purchases in trade payables.

Directors report

continued

POLITICAL AND CHARITABLE DONATIONS

The Company made no political or charitable donations during the year (2010: £nil).

DIRECTORS AND DIRECTORS' INTERESTS

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

K D'Silva* (Chairman)
Dr K Johnson (Chief Executive)
Professor DT Clark*
Dr G Gould
KM Baker OBE*
RD Gledhill*

The Company Secretary is GV Hall.

*denotes non-executive Director.

The Directors retiring by rotation are K D'Silva and K Johnson who, being eligible, offers themselves for re-election. DT Clark has decided to retire from the Board. The Board wishes to record its thanks to Mr. Clark for his considerable contribution since the inception of the Company and wishes him every success in the future.

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

	% of issued share capital at end of year	Number of £0.01 ordinary shares Interest at end of year	Interest at start of year
KM Baker OBE	1.0%	327,375	275,000
Professor DT Clark	3.1%	979,661	979,661
K D'Silva	1.0%	328,986	311,986
RG Gledhill	22.2%	7,072,223	7,072,223
Dr G Gould	0.0%	4,350	4,350
Dr K Johnson	0.4%	124,000	124,000

According to the register of Directors' interests, no rights to subscribe for shares in or debentures of the Company were granted to any of the Directors or their immediate families, or exercised by them during the financial year, except as disclosed in the report on Directors' remuneration on pages 11 and 12.

The Directors benefited from qualifying third party indemnity provisions in place during the financial year and at the date of this report.

SUBSTANTIAL SHAREHOLDERS

In addition to the Directors' interests noted above, the Directors are aware of the following who were interested in 3% or more of the Company's equity as at 6 July 2011:

Registered holding	Number of ordinary shares	% of issued share capital
JM Finn Nominees Limited	5,703,117	17.9%
Pershing Nominees Limited	2,506,000	7.9%
Giltspur Nominees Limited	1,642,801	5.2%
HSBC Gobal Custody Nominee (UK)	1,471,875	4.6%

CORPORATE GOVERNANCE

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

The Board has appointed an Audit Committee whose primary role is to review the Company's interim and annual financial statements before submission to the Board for approval. The Board has also appointed a Remuneration Committee, which is responsible for reviewing executive remuneration and performance. The Remuneration Committee is made up of four non-executive Directors, Professor David Clark, Kevin D'Silva, Ken Baker OBE and Richard Gledhill. The Audit Committee is made up of three non-executive Directors, Professor David Clark, Kevin D'Silva and Ken Baker OBE. Details of the Remuneration Committee are disclosed in the report on Directors' remuneration on pages 11 and 12.

GOING CONCERN

The financial statements have been prepared on a going concern basis which the Directors believe to be appropriate. The Company incurred a net loss of £870,961 during the year however the Directors are satisfied, based on detailed cash flow projections, that sufficient cash is available to meet the Company's needs as they fall due for at least 12 months from the date of signing the accounts. Revenues are expected to continue to increase in the coming years resulting in the Company becoming profitable in due course.

The Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

DISCLOSURE OF INFORMATION TO AUDITORS

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

AUDITORS

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

FUND RAISING

The Company secured a fundraising of £1,188,150, net of expenses, during November 2010 by the issue of new ordinary shares at 17 pence per share to assist with working capital needs and enable investment in additional plant and equipment necessary to significantly increase in house production capacity and reduce the direct cost of manufacturing carbon ceramic discs.

By order of the Board

K D'Silva
Chairman

4 August 2011

Unit 4 Olympic Park
Poole Hall Road
Ellesmere Port
Cheshire CH66 1ST

Report on directors remuneration

POLICY ON EXECUTIVE DIRECTORS' REMUNERATION

The Remuneration Committee comprises of Kevin D'Silva, Professor David Clark, Ken Baker OBE and Richard Gledhill.

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

FEES FOR NON-EXECUTIVE DIRECTORS

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

DIRECTORS' REMUNERATION

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

	2011 £	2010 £
Executive directors		
Dr K Johnson	96,512	116,587
Dr G Gould	35,223	36,032
	131,735	152,619
Non-executive directors		
K D'Silva	25,530	27,000
Professor DT Clark	18,000	18,000
KM Baker OBE	18,200	18,000
RD Gledhill	10,500	12,000
	72,230	75,000
	203,965	227,619

With the exception of Kevin Johnson, none of the Directors received pension contributions in respect of their office. In addition to the emoluments received, as stated above, Kevin Johnson received £22,750 (2010: £10,000) in respect of pension contributions.

DIRECTORS' INTERESTS

Details of any contracts in which a Director has a material interest are disclosed in note 17.

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

Report on directors remuneration

continued

SHARE OPTIONS

The Company operates a share incentive scheme. All options are granted at the discretion of the Board. The number of options granted, date of grant, exercise price and exercise periods under the scheme are set out below.

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

Director	Date of Grant	Holding on 1 June 2010	Granted during the year	Number of Share options expired, waived or lapsed	Holding on 31 May 2011	Exercise Price	Exercise Period	Expiry Date
Dr G Gould	18/04/2007	50,000	–	–	50,000	£0.21	18/04/10-18/04/17	18/04/2017
Dr G Gould	30/06/2008	86,000	–	–	86,000	£0.18	30/06/11-30/06/18	30/06/2018
Dr G Gould	22/09/2008	21,219	–	–	21,219	£0.19	22/09/11-22/09/18	22/09/2018
Dr G Gould	01/03/2010	20,000	–	–	20,000	£0.09	01/03/13-01/03/20	01/03/2020
Dr K Johnson	18/04/2007	100,000	–	–	100,000	£0.21	18/04/10-18/04/17	18/04/2017
Dr K Johnson	30/06/2008	288,000	–	–	288,000	£0.18	30/06/11-30/06/18	30/06/2018
Dr K Johnson	22/09/2008	481,707	–	–	481,707	£0.19	22/09/11-22/09/18	22/09/2018
Dr K Johnson	01/03/2010	345,000	–	–	345,000	£0.09	01/03/13-01/03/20	01/03/2020
Prof. DT Clark	18/04/2007	15,000	–	–	15,000	£0.21	18/04/10-18/04/17	18/04/2017
KA D'Silva	18/04/2007	50,000	–	–	50,000	£0.21	18/04/10-18/04/17	18/04/2017
KM Baker OBE	18/04/2007	15,000	–	–	15,000	£0.21	18/04/10-18/04/17	18/04/2017
		1,471,926	–	–	1,471,926			

The market price of the shares at 31 May 2011 was 14 pence and during the year varied from 11.9 pence to 25.7 pence.

By order of the Board

K D'Silva
Chairman

4 August 2011

Unit 4 Olympic Park
Poole Hall Road
Ellesmere Port
Cheshire CH66 1ST

Statement of directors responsibilities

in respect of the annual report and the financial statements

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

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

Independent auditors report

to the members of Surface Transforms plc

We have audited the financial statements of Surface Transforms plc for the year ended 31 May 2011 set out on pages 15 to 33. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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 AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 13, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/private/cfm.

OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 May 2011 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

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

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

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

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

Richard Evans (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
St James' Square
Manchester M2 6DS
United Kingdom

4 August 2011

Statement of total comprehensive income

for the year ended 31 May 2011

	Note	2011 £	2010 £
Revenue	2	863,439	804,800
Cost of sales		(342,654)	(358,537)
Gross profit		520,785	446,263
Administrative expenses:			
Before research costs		(711,902)	(698,791)
Research costs		(996,880)	(670,201)
Total administrative expenses		(1,708,782)	(1,368,992)
Other operating income	3	215,364	177,589
Operating loss		(972,633)	(745,140)
Financial income	6	2,124	339
Financial expenses	6	(3,379)	(2,289)
Loss before tax		(973,888)	(747,091)
Taxation	7	102,927	211,071
Loss for the year after tax	15	(870,961)	(536,019)
Other comprehensive income		–	–
Total comprehensive income for the year		(870,961)	(536,019)
Loss per ordinary share			
Basic and diluted	18	(3.09p)	(2.33p)

All amounts relate to continuing activities.

Statement of changes in equity

for the year ended 31 May 2011

	Share capital £	Share premium account £	Capital reserve £	Retained earnings £	Total £
For the year to 31 May 2011					
Balance at 31 May 2010	243,474	6,191,943	463,885	(5,820,169)	1,079,133
Loss for the year	–	–	–	(870,961)	(870,961)
Total comprehensive income for the year	243,474	6,191,943	463,885	(6,691,130)	208,172
Transactions with owners, recorded directly to equity					
Shares issued in the year	75,381	1,112,769	–	–	1,188,150
Equity settled share based payments	–	–	–	93,285	93,285
Total contributions by and distributions to the owners	75,381	1,112,769	–	93,285	1,281,435
Balance at 31 May 2011	318,855	7,304,712	463,885	(6,597,845)	1,489,607

	Share capital £	Share premium account £	Capital reserve £	Retained earnings £	Total £
For the year to 31 May 2010					
Balance at 31 May 2009	190,308	5,749,952	463,885	(5,377,622)	1,026,523
Loss for the year	–	–	–	(536,019)	(536,019)
Total comprehensive income for the year	190,308	5,749,952	463,885	(5,913,641)	490,504
Transactions with owners, recorded directly to equity					
Shares issued in the year	53,166	441,991	–	–	495,157
Equity settled share based payments	–	–	–	93,472	93,472
Total contributions by and distributions to the owners	53,166	441,991	–	93,472	588,629
Balance at 31 May 2010	243,474	6,191,943	463,885	(5,820,169)	1,079,133

Balance sheet

at 31 May 2011

	Note	2011 £	2011 £	2010 £	2010 £
Non-current assets					
Property, plant and equipment	8		291,388		355,909
Current assets					
Inventories	9	304,251		203,041	
Trade and other receivables	10	604,027		450,416	
Cash and cash equivalents		615,145		414,513	
			1,523,423		1,067,970
Total assets			1,814,811		1,423,879
Current liabilities					
Other interest bearing loans and borrowings	11	(10,230)		(20,614)	
Trade and other payables	12	(314,974)		(313,902)	
		(325,204)		(334,516)	
Non current liabilities					
Other interest bearing loans and borrowings	11	–		(10,230)	
Total liabilities			(325,204)		(344,746)
Net assets			1,489,607		1,079,133
Equity					
Share capital	14		318,855		243,474
Share premium	15		7,304,712		6,191,943
Capital reserve	15		463,885		463,885
Retained earnings	15		(6,597,845)		(5,820,169)
Total equity attributable to equity shareholders of the Company			1,489,607		1,079,133

These financial statements were approved by the Board of Directors on 4 August 2011 and were signed on its behalf by:

K D'Silva
Director

Dr K Johnson
Director

Cash flow statement

for the year ended 31 May 2011

	Note	2011 £	2010 £
Cash flows from operating activities			
Loss for the year		(870,961)	(536,019)
Adjusted for:			
Depreciation charge		72,299	70,904
Equity settled share-based payment expenses		93,285	93,472
Financial income		(2,124)	(339)
Financial expense		3,379	2,289
Taxation		(102,927)	(211,071)
		(807,049)	(580,764)
Changes in working capital			
(Increase)/decrease in inventories		(101,210)	25,210
Increase in trade and other receivables		(153,611)	(237,565)
Increase in trade and other payables		1,072	145,233
		(1,060,798)	(647,886)
Finance income received	6	2,124	339
Financial expense paid	6	(3,379)	(2,289)
Taxation received	7	102,927	211,071
Net cash used in operating activities		(959,126)	(438,765)
Cash flows from investing activities			
Acquisition of property, plant and equipment	8	(7,778)	(44,365)
Net cash used in investing activities		(7,778)	(44,365)
Cash flows from financing activities			
Proceeds from issue of share capital		1,188,150	495,157
Proceed from new finance lease		–	13,123
Payment of finance lease liabilities		(20,614)	(14,912)
Net cash from financing activities		1,167,536	493,368
Net increase in cash and cash equivalents		200,632	10,238
Cash and cash equivalents at the beginning of the period		414,513	404,275
Cash and cash equivalents at the end of the period		615,145	414,513

Notes to the financial statements

for the year ended 31 May 2011

1 ACCOUNTING POLICIES

Surface Transforms plc ("the Company") is a Company incorporated and domiciled in the UK.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU.

The financial statements were approved by the Board on 4 August 2011.

Basis of preparation

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

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Going concern

The financial statements have been prepared on a going concern basis which the Directors believe to be appropriate. The Company incurred a net loss of £870,961 during the year however the Directors are satisfied, based on detailed cash flow projections, that sufficient cash is available to meet the Company's needs as they fall due for at least 12 months from the date of signing the accounts. Revenues are expected to continue to increase in the coming years resulting in the Company becoming profitable in due course.

Further information regarding the Company's business activities, together with the factors likely to affect future development, performance and position are set out in the Chairman's statement on pages 3 to 5 and the Director's report on pages 8 to 10. In addition, note 19 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and its exposures to credit risk and liquidity risk.

The Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Share based payments

The share option programme allows employees to acquire shares of the Company. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using an option pricing model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leases in which the Company assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and less accumulated impairment losses. Lease payments are accounted for as described below.

1 ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

Plant and machinery	–	12.5%-20% per annum
Fixtures and fittings	–	15% per annum
Motor vehicles	–	25% per annum
Leasehold improvements	–	Over life of lease

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the foreign exchange rate ruling at the balance sheet date and the gains or losses on translation are included in the income statement.

Leases

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Government grants

Revenue grants are credited to the statement of total comprehensive income, and included within other operating income, so as to match them with expenditure to which they relate.

Post retirement benefits

The Company does not operate a pension scheme, but does contribute to specific employees' personal pension schemes. The amount charged to the profit and loss account represents the contributions payable to employees personal pension schemes during the accounting year.

Research and development expenditure

Expenditure on research activities is recognised in the income statement as an expense as incurred.

Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Company intends and has the technical ability and sufficient resources to complete development, future economic benefits are probable and if the Company can measure reliably the expenditure attributable to the intangible asset during its development. No development costs met the criteria for capitalisation in the current or preceding years.

Inventories

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

Notes to the financial statements

continued

1 ACCOUNTING POLICIES (continued)

Taxation

The charge for taxation is based on the loss for the year and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes.

Deferred taxation is provided for in full at the tax rate which is expected to apply to the period when the deferred taxation is expected to be realised, including on tax losses carried forward.

Deferred taxation assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Research and development tax credits are recognised on a cash received basis as a reduction in the current tax payable as this is when the tax credit is considered recoverable as the associated uncertainties have been eliminated.

Cash and cash equivalents

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

Revenue

Revenue comprises income derived from the supply of carbon fibre materials. Revenue is recognised on transfer to the customer of significant risks and rewards of ownership, generally this will be when goods are despatched to the customer. Turnover excludes value added taxes.

Contractual arrangements exist with specific customers which set selling prices and target volumes for future periods. The revenue derived from specific purchase orders raised against these contracts is recognised in a consistent manner to that described above.

Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents and trade and other payables.

Trade and other receivables

Trade and other receivables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses.

Trade and other payables

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Capital management

The Company manages its capital to ensure that it will be able to continue as a going concern and satisfy its debt as it falls due whilst also maximising opportunities to progress the development of the business. The capital structure of the Company consists of cash and cash equivalents and equity attributable to share holders comprising issued capital.

The key indicator of capital management performance used by management is the level of cash and cash equivalents available to the Company. Cash balances are monitored on a daily basis to ensure that the actual position is in line with cash flow forecasts.

During the year additional cash of £1,188,150 was raised via the issue of share capital.

Interest rate risk

The Company finances its operations through cash. Cash resources are invested to attract the highest rates for periods that do not limit access to these resources.

1 ACCOUNTING POLICIES (continued)

Liquidity risk

With regard to liquidity, the Company's policy has throughout the year been to ensure that the Company is able at all times to meet its financial liabilities as and when they fall due.

Critical accounting estimates and judgements

The preparation of financial statements in conformity with adopted IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not already apparent from other sources. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to carrying amount of assets and liabilities within the next financial year are discussed below:

Impairment of property, plant and equipment

Property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate that the carrying amount of an asset is not recoverable.

Provision to write inventories down to net realisable value

The Company makes provisions for obsolescence based on historical experiences and management estimates of future events. Actual outcome could vary significantly from these estimates.

Research and development expenditure

The Board considers the definitions of research and development costs as outlined in IAS 38: Intangible assets when determining the correct treatment of costs incurred. Where such expenditure is technically and commercially feasible, the Company intends and has the technical ability and sufficient resources to complete development, future economic benefits are probable and if the Company can measure reliably the expenditure attributable to the intangible asset it is treated as development expenditure and capitalised on the balance sheet.

In considering whether an item of expenditure meets these criteria, the Board applies judgement. During the year all such expenditure has been expensed to the income statement on the grounds that it relates to feasibility studies to identify new applications for the technology or methods of improving the production process. As the technical feasibility of this work is unknown at the time the costs are incurred, none meet the criteria for capitalisation during the current or previous year.

Segmental reporting

The Board has reviewed the requirements of IFRS 8 "Operating Segments", including consideration of what results and information the Chief Executive reviews regularly to assess performance and allocate resources, and concluded that, as under IAS 14, all revenue falls under a single business segment.

The Directors consider the business does not have separate divisional segments as defined under IFRS 8. The Chief Executive assesses the commercial performance of the business based upon a single set of revenues, margins, operating costs and assets.

New standards and interpretations that have been endorsed, but which are not yet effective and not early adopted

There are no new endorsed standards, amendments to standards and interpretations which are not yet effective for the year ended 31 May 2011 and which will have a significant impact on the information reported by the company in future periods.

2 SEGMENT REPORTING

Due to the start up nature of the business the Company is currently focussed on building revenue streams from a variety of different markets. As there is only one manufacturing facility and this has capacity above and beyond the current levels of trade there is no requirement to allocate resources to or discriminate between specific markets or products. As a result the Company's chief operating decision maker, the Chief Executive, reviews performance information for the Company as a whole and does not allocate resources based on products or markets. In addition, all products manufactured by the Company are produced using similar processes.

Having considered this information in conjunction with the requirements of IFRS 8, as at the reporting date the Board of Directors have concluded that the Company has only one reportable segment, that being the manufacture and sale of carbon fibre materials.

Segment results	**2011 Total £**	**2010 Total £**
Segment revenues	863,439	804,800
Operating expenses	(1,836,072)	(1,549,940)
Results from operating activities	(972,633)	(745,140)
Net finance costs	(1,255)	(1,950)
Loss before tax	(973,888)	(747,090)
Segment assets	1,489,607	1,079,133

The Company considers it offers a single product, namely carbon fibre material, which is machined into differing shapes depending on the intended purpose of the end user.

Revenue by geographical destination is analysed as follows:

	2011 £	**2010 £**
United Kingdom	233,243	166,170
Rest of Europe	594,232	336,943
United States of America	35,964	301,687
	863,439	804,800

3 EXPENSES AND AUDITORS REMUNERATION

	2011 £	2010 £
Operating loss before taxation is stated		
after charging		
Depreciation of owned tangible fixed assets	72,299	70,904
Research costs expensed as incurred	996,880	670,201
Rents payable under operating leases – land and buildings	54,754	54,362
Rents payable under operating leases – Other	11,484	11,484
Exchange losses	6,251	4,699
Inventory write down	28,969	16,639
after crediting		
Exchange gains	2,207	2,802
Government grants	215,364	177,589

Audit of these financial statements

Amounts receivable by auditors and their associates in respect of:

Audit of financial statements pursuant to legislation	17,152	16,800

Government grants

Grants received comprise revenue grants from the Technology Strategy Board (formerly DTI).

These are subject to making expenditure as stipulated in the grant applications and to audit of the claims. There are no unfulfilled conditions or contingencies associated with government assistance received.

4 REMUNERATION OF DIRECTORS

The Company considers key management personnel as defined in IAS 24 "Related party disclosures" to be the Directors of the Company. The aggregate amount of emoluments paid to Directors in respect of qualifying services during the year was £203,965 (2010: £227,619). Of this £96,512, (2010: £116,587) was made to the highest paid Director and Company pension contributions of £22,750 (2010: £10,000) were made to a money purchase scheme on his behalf.

Pension contributions were not received by any other Director during either the current or prior year.

5 STAFF NUMBERS AND COSTS

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

	Number of employees 2011	2010
Directors	6	6
Other employees	20	15
	26	21

The aggregate payroll costs of these persons were as follows:

	2011 £	2010 £
Wages and salaries	663,452	572,722
Social security costs	68,472	60,524
Other pension costs (see note 16)	105,056	68,512
	836,980	701,758

6 FINANCIAL INCOME AND EXPENSES

	2011 £	2010 £
Financial income		
Bank interest receivable	2,124	339
Financial expenses		
Total interest expense on financial liabilities measured at amortised cost	3,379	2,289

7 TAXATION

Analysis of credit in year:

	2011 £	2010 £
UK corporation tax		
Research and development tax repayment	(102,927)	(211,071)
Income tax credit	(102,927)	(211,071)

Details of the unrecognised deferred tax asset are included in note 13.

Factors affecting the tax credit for the current period

The current tax credit for the year is lower (2010: lower) than the standard rate of corporation tax in the UK of 27.67% (2010: 28%). The differences are explained below:

Reconciliation of effective tax rate	2011 £	2010 £
Loss for the year	(870,961)	(536,019)
Total income tax credit	(102,927)	(211,071)
Loss excluding income tax	(973,888)	(747,090)
Current tax at average rate of 27.67% (2010: 28.00%)	(269,433)	(209,185)
Effects of:		
Non-deductible expenses	1,679	917
Change in unrecognised timing differences	3,285	(1,191)
Current year losses for which no deferred tax recognised	264,469	209,459
Tax incentives	(102,927)	(211,071)
Income tax credit (see above)	(102,927)	(211,071)

Factors that may affect future tax charges

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

8 PROPERTY, PLANT AND EQUIPMENT

	Leasehold improvements £	Plant and machinery £	Fixtures and fittings £	Total £
Cost				
At 31 May 2009	74,620	409,330	44,272	528,222
Additions	–	43,354	1,011	44,365
At 31 May 2010	74,620	452,684	45,283	572,587
Additions	–	5,928	1,850	7,778
At 31 May 2011	74,620	458,612	47,133	580,365
Depreciation				
At 31 May 2009	14,079	112,702	18,993	145,774
Charge for year	7,461	53,517	9,926	70,904
At 31 May 2010	21,540	166,219	28,919	216,678
Charge for year	7,462	56,638	8,199	72,299
At 31 May 2011	29,002	222,857	37,118	288,977
Net book value				
At 31 May 2009	60,541	296,628	25,279	382,448
At 31 May 2010	53,080	286,465	16,364	355,909
At 31 May 2011	45,618	235,755	10,015	291,388

At 31 May 2011 the net carrying amount of leased plant and machinery was £48,235 (2010: £56,777).

9 INVENTORIES

	2011 £	2010 £
Raw materials and consumables	27,184	30,481
Work in progress	277,067	172,560
	304,251	203,041

Raw materials, consumables and changes in finished goods and work in progress recognised as cost of sales in the year amounted to £342,654 (2010: £358,537).

10 TRADE AND OTHER RECEIVABLES

	2011 £	2010 £
Trade receivables	480,716	285,910
Other receivables	74,178	112,024
Prepayments and accrued income	49,133	52,482
	604,027	450,416

All receivables fall due within one year.

Notes to the financial statements

continued

11 OTHER INTEREST-BEARING LOANS AND BORROWINGS

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Company's exposure to interest rate and foreign currency risk, see note 19.

	2011 £	2010 £
Current liabilities		
Current portion of finance lease liabilities	10,230	20,614
Non-current liabilities		
Finance lease liabilities	–	10,230

Finance lease liabilities are payable as follows:

	Future minimum lease payments 2011 £	Interest 2011 £	Present value of minimum lease payments 2011 £	Future minimum lease payments 2010 £	Interest 2010 £	Present value of minimum lease payments 2010 £
Less than one year	11,228	998	10,230	23,993	3,379	20,614
Between one and five years	–	–	–	11,228	998	10,230
	11,228	998	10,230	35,221	4,377	30,844

12 TRADE AND OTHER PAYABLES: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2011 £	2010 £
Trade payables	190,297	165,752
Taxation and social security	38,563	36,506
Accruals and deferred income	86,114	111,644
	314,974	313,902

13 DEFERRED TAX

The elements of deferred taxation are as follows:

	2011 £	2010 £
Difference between accumulated depreciation and amortisation and capital allowances	28,862	35,908
Other short term timing differences	–	(2,015)
Tax losses	(829,724)	(625,883)
Unrecognised deferred tax asset	(800,862)	(591,990)

The Company has an unrecognised deferred tax asset at 31 May 2011 of £800,862 (2010: £591,990) relating principally to tax losses which the Company can offset against future taxable profits from the same trade.

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

14 CALLED UP SHARE CAPITAL

	2011 £	2010 £
Authorised		
40,000,000 ordinary shares of £0.01 each (2010: 30,000,000 shares of £0.01 each)	400,000	300,000
Allotted, called up and fully paid		
31,885,442 shares of £0.01 each (2010: 24,347,328 shares of £0.01 each)	318,855	243,474

An additional 7,538,094 shares were issued in November 2010, for a total consideration of £1,188,150, net of expenses.

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

The options granted to Directors, date of grant and exercise price and exercise periods under the scheme are set out in the report on Directors' remuneration on pages 11 and 12. In addition to the Directors' share options, certain employees have been granted the following options:

Date of grant	Number of unexpired share options at year end	Exercise price	Exercise period
18/04/2007	160,000	£0.21	18/04/10-18/04/17
30/06/2008	146,200	£0.18	30/06/11-30/06/18
22/09/2008	557,547	£0.18	22/09/11-22/09/18
01/03/2010	320,000	£0.09	01/03/13-01/03/20

There are a total of 1,183,747 unexpired options held by employees and a total of 1,471,926 unexpired options held by Directors.

15 SHARE PREMIUM AND RESERVES

	Share premium account £	Capital reserve £	Retained earnings £
At 31 May 2009	5,749,952	463,885	(5,377,622)
Retained loss for the year	–	–	(536,019)
Share issue	441,991	–	–
Reversal of charge in relation to share based payments	–	–	93,472
At 31 May 2010	6,191,943	463,885	(5,820,169)
Retained loss for the year	–	–	(870,961)
Share issue	1,112,769	–	–
Reversal of charge in relation to share based payments	–	–	93,285
At 31 May 2011	7,304,712	463,885	(6,597,845)

16 PENSION SCHEME

The Company contributes to specific employees' personal pension schemes. The pension charge for the year represents contributions payable by the Company to the schemes and amounted to £105,056 (2010: £68,512). During the year one director and several senior managers opted to enter into salary exchange arrangements whereby they sacrificed salary for increased pension contributions. These arrangements accounted for £74,675 of the pension contributions (2010: £35,225).

There were outstanding contributions of £nil (2010: £nil) at the end of the financial year.

17 RELATED PARTY DISCLOSURES

The Company purchased goods and services to the value of £5,000 from Design Q Limited.

Kenneth Baker OBE, a non-executive director of Design Q Limited, is a non-executive Director of the Company.

All transactions with related parties are carried out at arms length. As at 31 May 2011, there were no amounts outstanding with Design Q Limited (2010: £nil).

18 LOSS PER ORDINARY SHARE

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

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

Basic	2011 £	2010 £
Loss after tax	(870,961)	(536,019)
Weighted average number of shares	28,229,963	23,012,231
Loss per share	(3.09p)	(2.33p)

The calculation of diluted loss per ordinary share is identical to that used for the basic loss per ordinary share. This is because the exercise of options would have the effect of reducing the loss per ordinary share from continuing operations and is therefore not dilutive under the terms of IAS33.

19 FINANCIAL INSTRUMENTS

The Company's policies with regard to financial instruments are set out within the accounting policies note. The risks arising from the Company's financial assets and liabilities are set out below with the policies for their respective management.

Currency Risk

The Company transacts business in foreign currencies and therefore incurs some transaction risk.

The Company had no open foreign exchange contracts at the Balance Sheet date.

The Company's exposure to foreign currency risk was as follows, this is based on the carrying amount for monetary financial instruments:

	31 May 2011			31 May 2010		
	US Dollar £	Euro £	Sterling £	US Dollar £	Euro £	Sterling £
Cash and cash equivalents	–	–	615,145	–	–	414,513
Trade receivables	–	64,467	416,249	–	61,716	224,194
Trade payables	(36,007)	(407)	(153,882)	(1,316)	(10,516)	(153,920)
Finance lease liabilities	–	–	(10,230)	–	–	(30,844)
Net exposure	(36,007)	64,060	867,282	(1,316)	51,200	453,943

	Average Rate		Reporting Date Spot Rate	
	2011	2010	2011	2010
US Dollar	1.580	1.596	1.647	1.423
Euro	1.174	1.135	1.153	1.178

19 FINANCIAL INSTRUMENTS (continued)

Sensitivity Analysis

A ten percent strengthening of the pound against the US Dollar and the Euro at 31 May 2011 would have (decreased)/increased profit by the amounts below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2010.

	US Dollar £	Euro £
31 May 2011	3,273	(5,823)
31 May 2010	120	(4,654)

A ten percent weakening of the pound against the US Dollar and the Euro at 31 May 2011 would have an equal and opposite effect to the amounts shown above, on the basis all other variables remain constant.

Price Risk

The Company aims to minimise its exposure to supplier price increases and customer price decreases by offsetting reciprocal supplier and customer arrangements.

Credit Risk

The Company operates a closely monitored collection policy.

The ageing of trade receivables at the reporting date was:

	31 May 2011			31 May 2010		
	Gross £	Impairment £	Net £	Gross £	Impairment £	Net £
Not past due	451,938	–	451,938	227,232	–	227,232
Past due 0 to 30 days	11,840	–	11,840	11,840	–	11,840
Past due 31 to 90 days	16,938	–	16,938	46,838	–	46,838
	480,716	–	480,716	285,910	–	285,910

The was no movement in the allowance for impairment in respect of trade receivables.

Liquidity Risk

The Company's objective is to maintain a balance between continuity and flexibility of funding through the use of short term deposits.

The contractual maturity of all cash and cash equivalents, trade and other receivables at the current and preceding balance sheet date is within one year.

The contractual maturity of trade and other payables at the current and preceding balance sheet date is within three months.

The contractual maturity of finance lease liabilities can be found in note 11.

19 FINANCIAL INSTRUMENTS (continued)

Interest Rate Risk

At the balance sheet date the interest rate profile of the Company's interest-bearing financial instruments was:

	2011 £	2010 £
Fixed rate instruments		
Finance lease liabilities	10,230	30,844

The Company has cash deposits of £498,772 (2010: £413,251).These funds are placed on premium rate deposit at rates which tracks bank base rate. These deposits are reviewed at least every 30 days. These funds are available on demand. At the year end, the weighted average interest rate for the floating rate cash deposits was the Barclays base rate of 0.50% (2010: 0.50% Barclays).

Fair values of the Company's financial assets and liabilities

Trade and other receivables

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the balance sheet date if the effect is material.

Trade and other payables

The fair value of trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the balance sheet date if the effect is material.

Cash and cash equivalents

The fair value of cash and cash equivalents is estimated as its carrying amount, all cash and cash equivalents are repayable on demand.

Interest-bearing borrowings

Fair value, which after initial recognition is determined for disclosure purposes only, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the balance sheet date if the effect is material.

The fair value of financial assets and liabilities, together with the carrying amounts shown in the balance sheet are as follows:

	2011		2010	
	Carrying value £	Fair value £	Carrying value £	Fair value £
Financial assets				
Cash and cash equivalents	615,145	615,145	414,513	414,513
Loans and receivables				
Trade receivables	480,716	480,716	285,910	285,910
Total financial assets	1,095,861	1,095,861	700,423	700,423
Financial liabilities at amortised cost				
Trade payables	(190,297)	(190,297)	(165,752)	(165,752)
Finance lease liabilities	(10,230)	(10,230)	(30,844)	(30,844)
Total financial liabilities	(200,527)	(200,527)	(196,596)	(196,596)

20 COMMITMENTS

Non-cancellable operating lease rentals are payable as follows:

	2011		2010	
	Land and buildings £	Motor vehicles £	Land and buildings £	Motor vehicles £
Within one year	54,754	5,757	54,754	11,439
In the second to fifth years inclusive	9,841	–	64,595	5,757
	64,595	5,757	119,349	17,196

21 SHARE BASED PAYMENTS

Share Options

The number of options outstanding under the Company's share option scheme is as follows:

Number of Share Options – Ordinary Shares at 1p

Note	At 31 May 2010	Granted	Surrendered	Lapsed	At 31 May 2011	Exercise price	Date from which exercisable	Expiry date
(a)	279,125	–	–	–	279,125	£0.21	18/04/2009	18/04/2017
(b)	110,875	–	–	–	110,875	£0.21	18/04/2009	18/04/2017
(a)	457,200	–	–	–	457,200	£0.18	30/06/2011	30/06/2018
(b)	63,000	–	–	–	63,000	£0.18	22/09/2011	22/09/2018
(a)	847,035	–	–	–	847,035	£0.19	30/06/2011	30/06/2018
(b)	213,438	–	–	–	213,438	£0.19	22/09/2011	22/09/2018
(a)	340,000	–	–	–	340,000	£0.09	01/03/2013	01/03/2020
(b)	345,000	–	–	–	345,000	£0.09	01/03/2013	01/03/2020
	2,655,673	–	–	–	2,655,673			

(a) These options have been granted under the EMI approved scheme. There have been no variations to the terms and conditions or performance criteria attached to these share options during the financial year. There are no performance conditions attached to these shares other than continued employment by the Company.

(b) These options have been granted under the unapproved scheme. There have been no variations to the terms and conditions or performance criteria attached to these share options during the financial year. There are no performance conditions attached to these shares other than continued employment by the Company.

There was no cost payable by the employees on the grant of any of the above options.

The option holder may only exercise his options during employment with the Company.

21 SHARE BASED PAYMENTS (continued)

The movements of the EMI and unapproved share options outstanding are shown below:

	EMI Scheme		Unapproved Scheme	
	Number of awards	Weighted average exercise price £	Number of awards	Weighted average exercise price £
Outstanding at 31 May 2009	1,616,652	0.19	387,313	0.19
Granted	340,000	0.09	345,000	0.09
Forfeited and surrendered	(33,282)	0.19	–	–
Outstanding at 31 May 2010	1,923,370	0.17	732,313	0.14
Granted	–	–	–	–
Forfeited and surrendered	–	–	–	–
Outstanding at 31 May 2011	1,923,370	0.17	732,313	0.14
Range of exercise prices	9p to 21p		9p to 21p	
Weighted average remaining contractual life	7 years 4 months		7 years 9 months	

There were no share options exercised during the year (2010: nil).

A charge of £93,285 (2010: £93,472) has been made in the statement of comprehensive income to spread the fair value of the options over the 3 year service obligations of those incentives.

Assumptions used in the valuation of share based options

In calculating the fair value of the share based payment arrangements the Company has used the Black Scholes method. There were no share options granted in 2011. The assumptions used to calculate the fair value of options issued in the previous financial year on the date of grant were as follows:

Weighted average assumptions	2011	2010
Fair value per share option	n/a	6.63p
Share price on date of grant	n/a	8.5p
Exercise price	n/a	9p
Share options granted in the year – EMI scheme	n/a	340,000
Share options granted in the year – Unapproved scheme	n/a	345,000
Expected volatility	n/a	90%
Exercise pattern (years)	n/a	3-10 years uniformly
Expected dividend yields	n/a	0%
Risk free rate of return	n/a	2%

The fair value of the share options is applied to the number of options that are expected to vest which takes into account the expected and actual forfeitures over the vesting period as a result of cessation of employment.

Expected volatility was determined by assessing the Company's historic data and the market in which the Company operates.

22 CAPITAL MANAGEMENT

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board of Directors monitors the return on capital, defined as net operating income divided by total shareholders' equity.

At present employees and Directors would hold 37% of the share capital, following the exercise of all outstanding share options.

Company information and advisers

WEBSITES	**www.surface-transforms.com** and **www.systemsST.com**
REGISTERED NUMBER	03769702
DIRECTORS	**Kevin D'Silva** (Non-executive Chairman) **Dr Kevin Johnson** (Chief Executive) **Dr Geoffrey Gould** (Sales and Marketing Director) **Professor David Thomas Clark** (Non-executive Director) **Kenneth Michael Baker OBE** (Non-executive Director) **Richard Douglas Gledhill** (Non-executive Director)
COMPANY SECRETARY	**Geoffrey Vernon Hall**
ADDRESS	Unit 4 Olympic Park Poole Hall Road Ellesmere Port Cheshire CH66 1ST
NOMINATED ADVISER	**Seymour Pierce Limited** 20 Old Bailey London EC4M 7EN
BROKERS	**Seymour Pierce Limited** 20 Old Bailey London EC4M 7EN
AUDITORS	**KPMG Audit Plc** St James' Square Manchester M2 6DS
SOLICITORS TO THE COMPANY	**Gateley (Manchester) LLP** 3 Hardman Square Spinningfields Manchester M3 3EB
BANKERS	**Barclays Bank plc** 125 Main Street Frodsham Cheshire WA6 7AD
REGISTRARS	**Capita Registrars** The Registry 34 Beckenham Road Beckenham Kent BR3 4TU

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the annual general meeting of Surface Transforms plc (the "Company") will be held at Unit 4 Olympic Park, Poole Hall Road, Ellesmere Port, Cheshire CH66 1ST, on 14 October 2011 at 12.00 noon for the following purposes:

ORDINARY BUSINESS

1. To receive the annual accounts of the Company for the financial year ended 31 May 2011 together with the last Directors' report, the last Directors' remuneration report and the auditors' report on those accounts.
2. To re-elect K D'Silva, who retires by rotation pursuant to article 113 of the articles of association of the Company and who, being eligible, offers himself for re-election as a Director.
3. To re-elect K Johnson who retires pursuant to article 113 of the articles of association of the Company and who, being eligible, offers himself for re-election as a Director.
4. To re-elect David Bundred, who was appointed during the year, retires in accordance with the articles of association of the Company and who, being eligible, offers himself for re-election as a Director.
5. To re-appoint KPMG Audit Plc as auditors of the Company and to authorise the Directors to fix their remuneration.

SPECIAL BUSINESS

To consider and, if thought fit, pass the following resolution which will be proposed as an ordinary resolution:

6. "THAT, in substitution for all existing and unexercised authorities and powers, the Directors of the Company be and they are hereby generally and unconditionally authorised for the purpose of section 551 of the Companies Act 2006 (the "Act"):

   (a) to exercise all or any of the powers of the Company to allot shares of the Company or to grant rights to subscribe for, or to convert any security into, shares of the Company (such shares and rights being altogether referred to as "Relevant Securities") up to an aggregate nominal value of £106,284 to such persons at such times and generally on such terms and conditions as the Directors may determine (subject always to the articles of association of the Company); and further

   (b) to allot equity securities (as defined in section 560 of the Act) up to an aggregate nominal value of £106,284 in connection with a rights issue or similar offer in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them subject only to such exclusions or other arrangements as the directors of the Company may consider appropriate to deal with fractional entitlements or legal and practical difficulties under the laws of, or the requirements of any recognised regulatory body in any territory,

   PROVIDED THAT this authority shall, unless previously renewed, varied or revoked by the Company in general meeting, expire at the conclusion of the next annual general meeting or on the date which is 6 months after the next accounting reference date of the Company (if earlier) save that the Directors of the Company may, before the expiry of such period, make an offer or agreement which would or might require relevant securities or equity securities (as the case may be) to be allotted after the expiry of such period and the Directors of the Company may allot relevant securities or equity securities (as the case may be) in pursuance of such offer or agreement as if the authority conferred hereby had not expired."

To consider and, if thought fit, pass the following resolution which will be proposed as a special resolution:

7. "THAT, subject to and conditional upon the passing of the resolution numbered 6 in the notice convening the meeting at which this resolution was proposed and in substitution for all existing and unexercised authorities and powers, the Directors of the Company be and are hereby empowered pursuant to section 570 of the Act to allot equity securities (as defined in section 560 of the Act) pursuant to the authority conferred upon them by resolution 6 as if section 561 of the Act did not apply to any such allotment provided that this authority and power shall be limited to:

   (a) the allotment of equity securities in connection with a rights issue or similar offer in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them subject only to such exclusions or other arrangements as the Directors of the Company may consider appropriate to deal with fractional entitlements or legal and practical difficulties under the laws of, or the requirements of any recognised regulatory body in any, territory; and

(b) the allotment (otherwise than pursuant to sub-paragraph (a) above) of equity securities up to an aggregate nominal amount of £31,885, representing approximately 10% of the current issued share capital of the Company,

and shall expire at the conclusion of the next annual general meeting or on the date which is 6 months after the next accounting reference date of the Company (if earlier) save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if the power conferred hereby had not expired."

By order of the Board

G V Hall
Company Secretary

Dated: 4 August 2011

Registered Office:
Unit 4 Olympic Park
Poole Hall Road
Ellesmere Port
Cheshire CH66 1ST

Company number: 3769702

Notes:

1. A member of the Company entitled to attend and vote at the meeting convened by this notice is entitled to appoint one or more proxies to exercise any of his rights to attend, speak and vote at that meeting on his behalf. If a member appoints more than one proxy, each proxy must be entitled to exercise the rights attached to different shares. A proxy need not be a member of the Company.
2. A proxy may only be appointed using the procedures set out in these notes and the enclosed proxy form. To appoint a proxy, a member must complete, sign and date the enclosed proxy form and deposit it at the office of the Company's Registrars, Capita Registrars, PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU by 12.00 noon on 12 October 2011. Any power of attorney or any other authority under which the proxy form is signed (or a duly certified copy of such power or authority) must be enclosed with the proxy form.
3. In order to revoke a proxy appointment, a member must sign and date a notice clearly stating his intention to revoke his proxy appointment and deposit it at the office of the Company's Registrars, Capita Registrars, PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU by 12.00 noon on 12 October 2011.
4. CREST members who wish to appoint a proxy or proxies by utilising the CREST electronic proxy appointment service may do so in relation to the meeting, and any adjournment(s) thereof, by utilising the procedures described in the CREST Manual. In order for a proxy appointment made by means of CREST to be valid, the appropriate CREST message must be transmitted so as to be received by the Company's registrars, Capita Registrars (whose CREST ID is RA10) by the latest time for receipt of proxy appointments specified in note 2 above. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the Company's agent is able to retrieve the message by enquiry to CREST in the manner prescribed. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
5. Any corporation which is a member of the Company may authorise a person (who need not be a member of the Company) to attend, speak and vote at the meeting as the representative of that corporation. A certified copy of the Board resolution of the corporation appointing the relevant person as the representative of that corporation in connection with the meeting must be deposited at the office of the Company's Registrars prior to the commencement of the meeting.
6. Only those persons whose names are entered on the register of members of the Company at 6 p.m. on 12 October 2011 shall be entitled to attend and vote in respect of the number of shares registered in their names at that time. Changes to entries on the register of members after that time shall be disregarded in determining the rights of any person to attend and/or vote at the meeting.
7. The return of a completed proxy form, other such instrument or any CREST proxy instruction (see note 4) does not preclude you from attending the meeting and voting in person. If you have appointed a proxy and attend the meeting in person, your proxy appointment will automatically be terminated.

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