Surface Transforms plc

Registered number 3769702

Annual Report and Financial Statements

for the year ended 31 May 2012

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for the year ended 31 May 2012

Contents

Highlights

- Revenue increased by 16% to £1.0 million (2011: £863k)
- Improved gross margin during the year of 63% (2011: 60%)
- Loss before taxation reduced to £637k (2011: £974k)
- Cash used in operating activities fell by 75% to £237k (2011: £959k)
- Cash position as at 31 May 2012 of £547k (2011: £615k)
- January 2012, Company entered into 3 year supply agreement with key client, Alcon Components Ltd, with expected revenues of £2.5 million over contract term
- Additional new orders in the supercar market cumulatively worth £100k p.a. when production of those models commences in FY 2013/14
- Ongoing testing by mainstream automotive vehicle OEM's and an internationally renowned aerospace brake system supplier

Chairman's statement and Chief Executive's report

Chairman's statement

It gives me great pleasure to report both financial and operational progress for Surface Transforms during the past year.

Financial progress is reflected in the headline results for the year ended 31 May 2012, in particular, a 16% increase in revenues to £1.0 million (2011: £863k) whilst improving gross margins to 63% (2011: 60%) and a 35% reduction in losses before taxation of £637k (2011: £974k).

Operational progress can be demonstrated against our immediate strategic objectives:

- mainstream volume acceptance of carbon ceramic brakes in the volume road car market which will be the result of a process with four (overlapping) stages. In particular, our objectives are to gain:
  - adoption in the retrofit market by both converters from iron discs to carbon ceramic and from switching from competitor carbon ceramic products as a result of superior performance;
  - adoption, as standard fitment, by super car manufacturers, and whilst often individually small are collectively significant in terms of engineering learning and short term cash flow;
  - adoption by the volume road car manufacturers for either standard fitment on limited edition models or options on the high performance volume cars; and
  - adoption as standard fitment on high performance cars. This remains our ultimate objective but the Board recognise this is unlikely to be achieved in the next 24 months;
- success in the automotive industry is nearly always a function of cost. The Board has set the objective of providing a ceramic brake rotor product at half the current manufacturing cost, progressively, by FY 2014/15. Resultant lower selling prices should provide opportunities in new road car segments and we are optimistic that our products will prove very competitive when compared to those of our competitors;
- acceptance within the aerospace market which the Board continues to view as offering a significant longer term contribution to shareholder value (albeit lower volumes than road car); the target segment is the lighter (but actually higher volume) aeroplanes rather than heavier aircraft currently using carbon brakes; and

However, our immediate objective remains achieving cash break even in FY 2012/13 for which, the Board considers revenues of £1.9 million would need to be generated.

Against these objectives it is encouraging to report continuing improved sales. Distributors are key to penetrating the after-market and our relationships with our two key partners – Alcon (in UK and Asia) and Mov'It (in UK and Europe) – continue to evolve. In the supercar market Surface Transforms recently won orders with Kepler Motors, Gumpert and Hennessey Performance to add to our existing customer base.

It is also particularly pleasing to report that certain volume road car manufacturers are now testing SurfaceTransforms products for adoption on limited edition versions. We are confident that one or more of these projects will, in time lead to adoption on a project.

In aerospace our development activities continue to progress, with commercialisation of new technology always slower in aerospace than automotive. Our long term contract with a development partner has focused on the commercialisation of ceramic brakes in two markets:

1. replacement of metallic friction brakes in the small commercial aircraft industry providing improved brake performance and weight saving; and
2. applications requiring static brake friction performance.

In respect of cost, the Board is particularly pleased with progress in this area. Surface Transforms has clear plans for both further cost reduction and also the streamlining of production processes to reduce lead times and therefore working capital, in particular, inventory. These targeted improvements require capital expenditure and Surface Transforms is engaged in advanced discussions with local enterprise authorities to support the Company's targeted expansion with incentives and grants.

FINANCIAL REVIEW

In the year ended 31 May 2012, revenues were £1.0 million (2011: £863k) which was in line with our expectations. Gross margin also improved during the year to 63% (2011: 60%) due to the successful implementation of our cost reduction programme, although these achievements were in part offset by the sale of more products of a lower gross margin compared to prior year.

Losses after taxation fell by 45% to £477k (2011: £871k) mainly due to increased contribution of £111k from sales, reduced net research costs expensed of £190k and payroll costs of £64k, together with a higher income tax credit of £58k. The reduction in research costs was a consequence of the Board's decision to decline further unpaid development activity and instead concentrate R&D efforts on the continued development of our technologies and products.

Looking ahead, our R&D tax credit advisers, Baker Tilly, has advised us we should continue to receive tax credits of £100k to £130k per annum based on forecast research activity.

At 31 May 2012, inventory was £403k (2011: £304k). This increase was required to support our projected increase in sales to the motor racing market during FY 2012/13.

The Board has continued to address the Company's production constraints and has purchased a new CVI furnace during the year, financed by a three year term loan of £285k.

Net cash used in operating activities reduced by a significant 75% to £237k from £959k last year, mainly due to reduced losses after tax (as above) and a decrease in trade receivables of £262k due to sales being generated more evenly during the second half of this year compared to 2011.

The Company had a cash balance of £547k at 31 May 2012 (2011: £615k).

Loss per share was 1.50 pence (2011: loss 3.09 pence).

Chief Executive's report

The Company is pleased to report increased revenues and reduced losses in line with our expectations. The increased revenues were generated from additional repeat sales of our automotive products, particularly from our contract with a leading global performance brake system supplier for products for the automotive racing markets.

Surface Transforms has seen significant improvements in both recognition and reputation of its high performance carbon ceramic brakes. These improvements are essential for future sales growth in the automotive retrofit market and are also strategically important to achieve volume car manufacturers' acceptance and approval. The objective in the current financial year is to resolve the inevitable technical anomalies arising from first exposure to serious road mileage and thereafter extend the product range.

Surface Transforms has been developing Porsche after-market disc replacement kits in partnership with its distributors. The Porsche after-market is a significant target market and these product extensions are expected to be launched during the summer and autumn of 2012 and will generate additional revenues to the Company in FY 2012/13 and beyond. We expect sales in Europe, Asia and North America through a US distributor with whom contract negotiations are underway for this important North American market.

In terms of operational improvements, our cost reduction programme has progressed well and in line with the Board's expectations. Manufacturing costs have been reduced by 18% but due to supply chain lead times, there is always a time lag between implementation and this cost being fully reflected in both the accounts and contract wins. Consequently, the improvement in gross margin reflected in the accounts actually understates the achievements in this area over the past twelve months.

During the next financial year, we are targeting a further 15% cost reduction, 5% of which is linked to the capital investment we have made in a new CVIST furnace. The CVI process is the Company's current capacity bottleneck and one of the most expensive parts of the manufacturing process. The new CVIST furnace will be commissioned in the autumn and is expected to more than triple our manufacturing capacity.

The Company's strategic cost saving and lead time reduction plan has identified significant further possible improvements but these will up to three years to implement fully. Once completed however, Surface Transforms expects to have a manufacturing plant that can produce a cost effective product with capacity and lead time acceptable for volume road car manufacture.

To assist in achieving these ambitions, the Company has received a Eureka Eurostar grant focused on reducing the cost and time to machine a carbon ceramic disc. The programme began in November 2011 and will be completed over the next two years.

DIRECTORS AND STAFF

We would like to thank all our colleagues, management and staff alike, for their hard work and dedication over the past year.

OUTLOOK

Surface Transforms continues to develop and is clearly progressing the commercialisation of its technology. The Board expects continuing sales growth and has the objective of being cash break even in the current financial year ending 31 May 2013.

David Bundred	**Kevin Johnson**
Chairman	Chief Executive

17 August 2012

Directors report

The Directors present their annual report and the audited financial statements for the year ended 31 May 2012.

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 £1,000,659 (2011: £863,439)
- Losses after taxation £476,709 (2011: £870,961)

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 £476,709 (2011: £870,961). 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 (2011: 55 days) purchases in trade payables.

Directors report

continued

POLITICAL AND CHARITABLE DONATIONS

The Company made no political or charitable donations during the year (2011: £nil).

DIRECTORS AND DIRECTORS' INTERESTS

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

D Bundred* (Chairman – Appointed 5 August 2011)
K D'Silva*
Dr K Johnson (Chief Executive)
Professor DT Clark* (Resigned 14 October 2011)
Dr G Gould (Resigned 14 October 2011)
KM Baker O.B.E.* (Resigned 31 January 2012)
RD Gledhill*

G V Hall retired from his position of Company Secretary and S Steel was appointed on 5 December 2011.

*denotes non-executive Director.

The Director retiring by rotation is R Gledhill.

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
K D'Silva	1.2%	386,486	328,986
RD Gledhill	24.0%	7,664,723	7,072,223
Dr K Johnson	0.4%	124,000	124,000
D Bundred	0.5%	150,000	–

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 9 and 10.

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 26 June 2012:

Registered holding	Number of ordinary shares	% of issued share capital
TD Direct Investing Nominees Limited	8,042,405	25.02%
J M Finn Nominees Limited	6,319,417	19.66%
Brooks MacDonald Nominees Limited	2,355,000	7.33%
Pershing Nominees Limited	2,201,700	6.85%
Octopus Investments Nominees	1,814,474	5.65%

Directors report

continued

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 three non-executive Directors, David Bundred, Kevin D'Silva and Richard Gledhill. The Audit Committee is made up of three non-executive Directors, David Bundred, Kevin D'Silva and Richard Gledhill. Details of the Remuneration Committee are disclosed in the report on Directors' remuneration on pages 9 and 10.

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 £476,709 during the year however the Directors are satisfied, based on detailed cash flow projections and after the consideration of reasonable sensitivities, 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 auditor 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 auditor 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.

By order of the Board

D Bundred
Chairman

17 August 2012

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 David Bundred, Kevin D'Silva 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:

	2012 £	2011 £
Executive directors		
Dr K Johnson	82,712	96,512
Dr G Gould (Resigned 14th October 2011)	10,642	35,223
	93,554	131,735
Non-executive directors		
K D'Silva	19,982	25,530
Professor DT Clark (Resigned 14 October 2011)	–	18,000
KM Baker O.B.E. (Resigned 31 January 2012)	5,250	18,200
RD Gledhill	17,023	10,500
D Bundred	23,625	–
	65,880	72,230
	159,434	203,965

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 £21,000 (2011: £22,750) 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.

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 2011	Granted during the year	Number of Share options expired, waived or lapsed	Holding on 31 May 2012	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	01/03/2011	345,000	–	–	345,000	£0.09	01/03/13-01/03/20	01/03/2020
Dr K Johnson	15/03/2012	–	330,000	–	330,000	£0.12	15/03/15-15/03/22	15/03/2022
Prof. DT Clark	18/04/2007	15,000	–	15,000	–	£0.21	18/04/10-18/04/17	18/04/2014
KM Baker OBE	18/04/2007	15,000	–	15,000	–	£0.21	18/04/10-18/04/17	18/04/2014
KA D'Silva	18/04/2007	50,000	–	–	50,000	£0.21	18/04/10-18/04/17	18/04/2017
D Bundred	17/10/2011	–	100,000	–	100,000	£0.09	17/10/11-18/10/21	18/10/2021
D Bundred	17/10/2011	–	100,000	–	100,000	£0.09	17/10/12-18/10/21	18/10/2021
D Bundred	17/10/2011	–	100,000	–	100,000	£0.09	17/10/13-18/10/21	18/10/2021
		1,471,926	630,000	30,000	2,071,926			

The market price of the shares at 31 May 2012 was 11.5 pence and during the year varied from 8.3 pence to 16.0 pence.

By order of the Board

D Bundred
Chairman

17 August 2012

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 2012 set out on pages 13 to 32. 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 11, 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/UKNP.

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 2012 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.

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

17 August 2012

Statement of total comprehensive income

for the year ended 31 May 2012

	Note	2012 £	2011 £
Revenue	2	1,000,659	863,439
Cost of sales		(368,534)	(342,654)
Gross profit		632,125	520,785
Administrative expenses:			
Before research costs		(638,438)	(711,902)
Research costs		(806,396)	(996,880)
Total administrative expenses	3	(1,444,834)	(1,708,782)
Other operating income	3	197,867	215,364
Operating loss		(614,842)	(972,633)
Financial income	6	4,448	2,124
Financial expenses	6	(26,985)	(3,379)
Loss before tax		(637,379)	(973,888)
Taxation	7	160,670	102,927
Loss for the year after tax	15	(476,709)	(870,961)
Other comprehensive income		–	–
Total comprehensive income for the year		(476,709)	(870,961)
Loss per ordinary share			
Basic and diluted	18	(1.50p)	(3.09p)

All amounts relate to continuing activities.

Statement of changes in equity

for the year ended 31 May 2012

For the year to 31 May 2012

	Share capital £	Share premium account £	Capital reserve £	Retained earnings £	Total £
Balance at 31 May 2011	318,855	7,304,712	463,885	(6,597,845)	1,489,607
Loss for the year	–	–	–	(476,709)	(476,709)
Total comprehensive income for the year	318,855	7,304,712	463,885	(7,074,554)	1,012,898
Transactions with owners, recorded directly to equity					
Equity settled share based payments	–	–	–	41,366	41,366
Total contributions by and distributions to the owners	–	–	–	41,366	41,366
Balance at 31 May 2012	318,855	7,304,712	463,885	(7,033,188)	1,054,264

For the year to 31 May 2011

	Share capital £	Share premium account £	Capital reserve £	Retained earnings £	Total £
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

Balance sheet

at 31 May 2012

	Note	2012 £	2012 £	2011 £	2011 £
Non-current assets					
Property, plant and equipment	8		288,454		291,388
Current assets					
Inventories	9	403,442		304,251	
Trade and other receivables	10	357,264		604,027	
Cash and cash equivalents		546,958		615,145	
			1,307,664		1,523,423
Total assets			1,596,118		1,814,811
Current liabilities					
Other interest bearing loans and borrowings	11	(89,011)		(10,230)	
Trade and other payables	12	(297,992)		(314,974)	
		(387,003)		(325,204)	
Non-current liabilities					
Other interest bearing loans and borrowings	11	(154,851)		–	
Total liabilities			(541,854)		(325,204)
Net assets			1,054,264		1,489,607
Equity					
Share capital	14		318,855		318,855
Share premium	15		7,304,712		7,304,712
Capital reserve	15		463,885		463,885
Retained earnings	15		(7,033,188)		(6,597,845)
Total equity attributable to equity shareholders of the Company			1,054,264		1,489,607

These financial statements were approved by the board of Directors on 17 August 2012 and were signed on its behalf by:

D Bundred
Director

Dr K Johnson
Director

Cash flow statement

for the year ended 31 May 2012

	Note	2012 £	2011 £
Cash flows from operating activities			
Loss for the year		(476,709)	(870,961)
Adjusted for:			
Depreciation charge		67,232	72,299
Fixed Asset Disposal		575	–
Equity settled share-based payment expenses		41,366	93,285
Financial income		(4,448)	(2,124)
Financial expense		26,985	3,379
Taxation		(160,670)	(102,927)
		(505,669)	(807,049)
Changes in working capital			
Increase in inventories		(99,191)	(101,210)
Decrease/(Increase) in trade and other receivables		246,763	(153,611)
(Decrease)/Increase in trade and other payables		(16,982)	1,072
		(375,079)	(1,060,798)
Finance income received	6	4,448	2,124
Financial expense paid	6	(26,985)	(3,379)
Taxation received	7	160,670	102,927
Net cash used in operating activities		(236,946)	(959,126)
Cash flows from investing activities			
Acquisition of property, plant and equipment	8	(64,873)	(7,778)
Net cash used in investing activities		(64,873)	(7,778)
Cash flows from financing activities			
Proceeds from issue of share capital		–	1,188,150
Proceeds from new loan		285,000	–
Payment of finance lease/loan liabilities		(51,368)	(20,614)
Net cash from financing activities		233,632	1,167,536
Net increase in cash and cash equivalents		(68,187)	200,632
Cash and cash equivalents at the beginning of the period		615,145	414,513
Cash and cash equivalents at the end of the period		546,958	615,145

Notes to the financial statements

for the year ended 31 May 2012

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 17 August 2012.

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 £477k during the year however the Directors are satisfied, based on detailed cash flow projections and after the consideration of reasonable sensitivities, that sufficient cash is available to meet the Company's needs as they fall due for the foreseeable future and 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 4 and the Director's report on pages 6 to 8. 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
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.

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.

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.

Notes to the financial statements

continued

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 2012 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	**2012 Total £**	**2011 Total £**
Segment revenues	1,000,659	863,439
Operating expenses	(1,615,501)	(1,836,072)
Results from operating activities	(614,842)	(972,633)
Net finance costs	(22,537)	(1,255)
Loss before tax	(637,379)	(973,888)
Segment assets	1,054,264	1,489,607

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:

	2012 £	**2011 £**
United Kingdom	228,545	233,243
Rest of Europe	748,843	594,232
United States of America	23,271	35,964
	1,000,659	863,439

Notes to the financial statements

continued

3 EXPENSES AND AUDITORS REMUNERATION

	2012 £	2011 £
Operating loss before taxation is stated		
after charging		
Depreciation of owned tangible fixed assets	67,232	72,299
Research costs expensed as incurred	806,396	996,880
Rents payable under operating leases – land and buildings	54,754	54,754
Rents payable under operating leases – other	17,710	11,484
Exchange losses	12,341	6,251
Inventory write down	29,604	28,969
after crediting		
Exchange gains	2,190	2,207
Government grants	197,867	215,364

Audit of these financial statements		
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements pursuant to legislation	18,100	17,152
All other services	1,500	–

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 £159,434 (2011: £203,965). Of this £82,912, (2011: £96,512) was made to the highest paid Director and Company pension contributions of £21,000 (2011: £22,750) 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 2012	 2011
Directors	5	6
Other employees	19	20
	24	26

The aggregate payroll costs of these persons were as follows:

	2012 £	2011 £
Wages and salaries	628,153	663,452
Social security costs	62,967	68,472
Other pension costs (see note 16)	82,160	105,056
	773,280	836,980

6 FINANCIAL INCOME AND EXPENSES

	2012 £	2011 £
Financial income		
Bank interest receivable	4,448	2,124
Financial expenses		
Total interest expense on financial liabilities measured at amortised cost	26,985	3,379

7 TAXATION

Analysis of credit in year:

	2012 £	2011 £
UK corporation tax		
Research and development tax repayment	(160,670)	(102,927)
Income tax credit	(160,670)	(102,927)

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 (2011: lower) than the standard rate of corporation tax in the UK of 25.67% (2011: 27.67%). The differences are explained below:

Reconciliation of effective tax rate	2012 £	2011 £
Loss for the year	(476,709)	(870,961)
Total income tax credit	(160,670)	(102,927)
Loss excluding income tax	(637,379)	(973,888)
Current tax at average rate of 25.67% (2011: 27.67%)	(163,615)	(269,433)
Effects of:		
Non-deductible expenses	12,876	1,679
Change in unrecognised timing differences	(6,121)	3,285
Current year losses for which no deferred tax recognised	156,860	264,469
Tax incentives	(160,670)	(102,927)
Income tax credit (see above)	(160,670)	(102,927)

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 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
Additions	–	56,760	8,113	64,873
Disposals	–	(3,250)	–	(3,250)
At 31 May 2012	74,620	512,122	55,246	641,988
Depreciation				
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
Charge for year	7,462	54,411	5,359	67,232
Charge on Disposal	–	(2,675)	–	(2,675)
At 31 May 2012	36,464	274,593	42.477	353,534
Net book value				
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 2012	38,156	237,529	12,769	288,454

At 31 May 2012 the net carrying amount of leased plant and machinery was £nil (2011: £48,235).

9 INVENTORIES

	2012 £	2011 £
Raw materials and consumables	64,806	27,184
Work in progress	338,636	277,067
	403,442	304,251

Raw materials, consumables and changes in finished goods and work in progress recognised as cost of sales in the year amounted to £368,534 (2011: £342,654).

10 TRADE AND OTHER RECEIVABLES

	2012 £	2011 £
Trade receivables	218,910	480,716
Other receivables	94,556	74,178
Prepayments and accrued income	43,798	49,133
	357,264	604,027

All receivables fall due within one year.

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.

	2012 £	2011 £
Current liabilities		
Loans	89,011	–
Finance lease liabilities	–	10,230
Non-current liabilities		
Loans	154,851	–

On 18 October 2011 the company took out a loan for £285,000 in order to fund the acquisition of a new CVIST furnace. This loan is repayable in equal instalments over a 3 year period and attracting interest of 10%.

Finance lease liabilities are payable as follows:

	Present minimum lease payments 2012 £	Interest 2012 £	Present value of minimum lease payments 2012 £	Future minimum lease payments 2011 £	Interest 2011 £	Present value of minimum lease payments 2011 £
Less than one year	–	–	–	11,228	998	10,230
Between one and five years	–	–	–	–	–	–
	–	–	–	11,228	998	10,230

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

	2012 £	2011 £
Trade payables	197,544	190,297
Taxation and social security	30,165	38,563
Accruals and deferred income	70,283	86,114
	297,992	314,974

13 DEFERRED TAX

	2012 £	2011 £
Difference between accumulated depreciation and amortisation and capital allowances	33,561	28,862
Other short term timing differences	(1,151)	–
Tax losses	(793,808)	(829,724)
Unrecognised deferred tax asset	(761,398)	(800,862)

The elements of the deferred taxation are as follows:

The Company has an unrecognised deferred tax asset at 31 May 2012 of £761,398 (2011: £800,862) 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

	2012 £	2011 £
Authorised		
40,000,000 ordinary shares of £0.01 each (2011: 40,000,000 shares of £0.01 each)	400,000	400,000
Allotted, called up and fully paid		
31,885,442 shares of £0.01 each (2011: 31,885,442 shares of £0.01 each)	318,855	318,855

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 9 and 10. 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	130,000	£0.21	18/04/10-18/04/17
30/06/2008	106,200	£0.18	30/06/11-30/06/18
22/09/2008	342,548	£0.18	22/09/11-22/09/18
01/03/2010	195,000	£0.09	01/03/13-01/03/20
15/02/2012	176.696	£0.12	15/02/15-15/02/02

There are a total of 950,444 unexpired options held by employees and a total of 2,071,926 unexpired options held by Directors.

15 SHARE PREMIUM AND RESERVES

	Share premium account £	Capital reserve £	Retained earnings £
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)
Retained loss for the year	–	–	(476,709)
Share issue	–	–	–
Reversal of charge in relation to share based payments	–	–	41,366
At 31 May 2012	7,304,712	463,885	(7,033,188)

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 £82,160 (2011: £105,056). 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 £49,670 of the pension contributions (2011: £74,675).

There were outstanding contributions of £nil (2011: £nil) at the end of the financial year.

17 RELATED PARTY DISCLOSURES

The Company purchased £nil goods from related parties.

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	2012 £	2011 £
Loss after tax	(476,709)	(870,961)
Weighted average number of shares	31,885,442	28,229,963
Loss per share	(1.50p)	(3.09p)

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

	31 May 2012			31 May 2011		
	US Dollar £	Euro £	Sterling £	US Dollar £	Euro £	Sterling £
Cash and cash equivalents	52,427	90	494,441	–	–	615,145
Trade receivables	–	75,111	143,799	–	64,467	416,249
Trade payables	(57,884)	–	(139,660)	(36,007)	(407)	(153,882)
Finance lease liabilities	–	–	–	–	–	(10,230)
Net exposure	5,457	75,201	498,580	(36,007)	64,060	867,282

	Average Rate		Reporting Date Spot Rate	
	2012	2011	2012	2011
US Dollar	1.590	1.580	1.574	1.647
Euro	1.174	1.174	1.243	1.153

Sensitivity Analysis

A ten percent strengthening of the pound against the US Dollar and the Euro at 31 May 2012 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 2011.

	US Dollar £	Euro £
31 May 2012	497	(6,836)
31 May 2011	3,273	(5,823)

A ten percent weakening of the pound against the US Dollar and the Euro at 31 May 2012 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.

The Company also deals in Forward Contracts to minimise the exposure.

19 FINANCIAL INSTRUMENTS (continued)

Credit Risk

The Company operates a closely monitored collection policy.

The ageing of trade receivables at the reporting date was:

	31 May 2012 Gross £	31 May 2012 Impairment £	31 May 2012 Net £	31 May 2011 Gross £	31 May 2011 Impairment £	31 May 2011 Net £
Not past due	136,478	–	136,478	451,938	–	451,938
Past due 0 to 30 days	44,469	–	44,469	11,840	–	11,840
Past due 31 to 90 days	37,963	–	37,963	16,938	–	16,938
	218,910	–	218,910	480,716	–	480,716

There 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.

Interest Rate Risk

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

	2012 £	2011 £
Fixed rate instruments		
Finance lease liabilities	–	10,230
Loan	243,862	–

The Company has cash deposits of £422,726 (2011: £498,772) 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 0.5% (2011: 0.50% Barclays).

19 FINANCIAL INSTRUMENTS (continued)

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:

	2012		2011	
	Carrying value £	**Fair value £**	**Carrying value £**	**Fair value £**
Financial assets				
Cash and cash equivalents	546,958	546,958	615,145	615,145
Loans and receivables				
Trade receivables	218,910	218,910	480,716	480,716
Total financial assets	765,868	765,868	1,095,861	1,095,861
Financial liabilities at amortised cost				
Trade payables	(197,544)	(197,544)	(190,297)	(190,297)
Loans	(243,862)	(243,862)	–	–
Finance lease liabilities	–	–	(10,230)	(10,230)
Total financial liabilities	(441,406)	(441,406)	(200,527)	(200,527)

20 COMMITMENTS

Non-cancellable operating lease rentals are payable as follows:

	2012		2011	
	Land and buildings £	**Motor vehicles £**	**Land and buildings £**	**Motor vehicles £**
Within one year	54,754	6,257	54,754	5,757
In the second to fifth years inclusive	205,327	10,429	9,841	–
	260,081	16,686	64,595	5,757

Capital commitments were £284,100 (2011: Nil) at 31 May 2012 in relation to a new furnace currently under construction.

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 2011	Granted	Surrendered	Lapsed	At 31 May 2012	Exercise price	Date from which exercisable	Expiry date
(a)	279,125	–	49,125	–	230,000	£0.21	18/04/2009	18/04/2017
(b)	110,875	–	10,875	–	100,000	£0.21	18/04/2009	18/04/2017
(a)	457,200	–	40,000	–	417,200	£0.18	30/06/2012	30/06/2018
(b)	63,000	–	–	–	63,000	£0.18	22/09/2012	22/09/2018
(a)	847,035	–	215,000	–	632,035	£0.19	30/06/2012	30/06/2018
(b)	213,438	–	–	–	213,438	£0.19	22/09/2012	22/09/2018
(a)	340,000	–	125,000	–	215,000	£0.09	01/03/2013	01/03/2020
(b)	345,000	–	–	–	345,000	£0.09	01/03/2013	01/03/2020
(b)	–	100,000	–	–	100,000	£0.09	17/10/2011	18/10/2021
(b)	–	100,000	–	–	100,000	£0.09	17/10/2012	18/10/2021
(b)	–	100,000	–	–	100,000	£0.09	17/10/2013	18/10/2021
(a)	–	176,696	–	–	176,696	£0.12	15/03/2015	15/03/2022
(b)	–	330,000	–	–	330,000	£0.12	15/03/2015	15/03/2022
	2,655,673	806,696	440,000	–	3,022,369			

(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 2010	1,923,370	0.17	732,313	0.14
Outstanding at 31 May 2011	1,923,370	0.17	732,313	0.14
Granted	176,696	0.12	630,000	0.11
Forfeited & surrendered	(556,354)	–	(60,875)	–
Outstanding at 31 May 2012	1,543,712	0.17	1,301,438	0.13
Range of exercise prices	9p to 21p		9p to 21p	
Weighted average remaining contractual life	6 years 11 months		7 years 11 months	

There were no share options exercised during the year (2011: nil).

A charge of £41,366 (2011: £93,285) 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.

Weighted average assumptions	2012	2011
Fair value per share option	9.02p	n/a
Share price on date of grant	11.5p	n/a
Exercise price	11.5p	n/a
Share options granted in the year – EMI scheme	176,696	n/a
Share options granted in the year – Unapproved scheme	630,000	n/a
Expected volatility	100%	n/a
Exercise pattern (years)	3-10 years uniformly	n/a
Expected dividend yields	0%	n/a
Risk free rate of return	2%	n/a

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 33% 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	**David Bundred** (Non-executive Chairman) **Dr Kevin Johnson** (Chief Executive) **Kevin D'Silva** (Non-executive Director) **Richard Douglas Gledhill** (Non-executive Director)
COMPANY SECRETARY	**Sarah Steel**
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** 3 Hardman Square Spinningfields Manchester M3 3EB
BANKERS	**Barclays Bank plc** 125 Main Street Frodsham Cheshire WA6 7AD **Natwest** Chester Branch 33 Eastgate Street Chester CH1 1LG
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 the above named Company will be held at Seymour Pierce Ltd, 20 Old Bailey, London, EC4M 7EN, on 30 October 2012 at 11.00 am for the following purposes:

ORDINARY BUSINESS

1. To receive the annual accounts of the Company for the financial year ended 31 May 2012 together with the last Directors' report, the last Directors' remuneration report and the auditors' report on those accounts.

2. To re-elect R Gledhill, 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-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:

4. "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 £107,137 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 £107,137 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:

5. "THAT, subject to and conditional upon the passing of the resolution numbered 5 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 5 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 interest 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 £32,141, 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

Sarah Steel
Company Secretary

Dated: 17 August 2012

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 at PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU by 12.00 noon on 26 October 2012. 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 at PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU by 12.00 noon on 26 October 2012.

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 26 October 2012 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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