Surface Transforms Plc

Registered number 3769702

Annual Report and Financial Statements

for the year ended 31 May 2014

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Highlights

- Revenues increased by £214k to £1.3 million (2013: £1.1 million).
- Gross margin during the year decreased to 56.2% (2013: 74.0%) which was as a result of the sale of more products with a lower gross margin compared to the previous year.
- EBITDA loss (including tax credit and exceptionals) of £583k (2013: loss of £497k).
- Loss before taxation of £842k (2013: £712k).
- Loss per share reduced to 1.65p (2013: 1.71p).
- Completed a placing in November 2013 for £327k from both institutional and private investors to further progress the Company's objectives towards 'game changing' new business.
- Cash used in operating activities increased by 28% to £501k to (2013: £392k).
- Cash position as at 31 May 2014 of £151k (2013: £457k).
- Significant progress with Tier One Original Equipment Manufacturers on winning 'game changer' contracts.
- Successfully changed retrofit distribution channels – albeit at a slower pace than planned.

Chairman's Statement

The Company continues to pursue two parallel, complementary but in practice very different strategies. In the short term the retrofit segment is crucial to both short term cash break even and securing road mile experience of the Company's products but ultimate shareholder value will arise from winning a significant – 'game changer' – mainstream contract with one or more OEMs (Original Equipment Manufacturers).

As announced by the Company on 12 June 2014, the year has been marked by disappointment in respect to achieving the first – cash breakeven – but we are satisfied in respect to the second objective, making considerable progress on the work needed to win a major OEM contract.

Whilst sales grew by £214k in the year a reduction in gross profit of £68k (largely the impact of sales mix) and increased research costs of £60k (reflecting increased activity with the OEMs), and reduced other operating income (principally grant income) £72k, offset by a decrease in income tax credit of £36k and reduction in exceptional costs of £72k from the prior year are the main reason for the deterioration in EBITDA of £86k.

Revenue growth was driven primarily by the rebound of sales to the major European brake manufacturer customer (who suffered supply chain problems in 2013), a repeat of the license income to the US clutch manufacturer but offset by reduced sales on retrofit road car. The issue in respect of lower retrofit road car sales has been previously described; the appointment of three "big" master distributors was not successful (as their distance from the ultimate customer and need to make an additional margin led to both communication and pricing difficulties). Consequently, the Company switched to a more direct sales approach (opening its own German sales office and offering web based sales) combined with the appointment of additional distributors who are closer to the track day community. This approach is having a positive impact on the summer 2014 sales season but still slower than planned.

The reduction in gross margin is entirely driven by sales mix. The gross margin within each individual market segment is broadly unchanged between the two years but the impact of the same license income on higher overall sales together with the substitution of higher margin road car sales with lower margin pre form sales has resulted in the reduction in both absolute and percentage gross margin.

Turning to the crucially important game changing OEM contracts:

- our principal, aerospace customer is in the process of agreeing a new, longer term commercial contract with the Company, and the board is confident that announcements can be made in the near future;
- two well-known UK car manufacturers are testing the company's products with specific models in mind while additionally, new German customers have now begun test programs. Technically the product meets all criteria for friction, noise, vibration and life however a new technical challenge/opportunity (for the whole industry) has arisen as some of the customers are not happy with a particular feature on competitors' products which is a particular challenge for one of our competitors. Surface Transforms believes that it can satisfy this new requirement and is in the process of proving it;
- the programs are real -model related-, the testing is underway and the company remains confident of the outcome; and
- additionally – in our chosen automotive market – product cost and lead time reductions are critical differentiators. In particular success in the automotive industry is nearly always a function of cost. We are therefore successfully implementing our programme to halve manufacturing costs and lead times in the next 2 to 3 years.

Finally, whilst we do not regard them as game changers – we continue to successfully pursue "near OEMs" (i.e. companies who either take existing models and customise them for high performance and/or luxury, and companies who build very specialist vehicles). Individual volumes would be between 10 and 200 cars per year. The marketing activity is bearing fruit as exemplified by the decision this year of BAC-Mono to offer Surface Transforms carbon discs on its option list. This could provide not only shorter term revenues but also generates road mile experience of our products.

David Bundred
Chairman

29 August 2014

Strategic Report

Financial review

In the year ended 31 May 2014, revenues were £1.3m (2013: £1.1 million) which was in line with our expectations. Gross margin weakened during the year to 56.2% (2013: 74.0%) due to the sale of more products of a lower gross margin compared to prior year.

Losses after taxation increased by 16% to £674k (2013: £580k) –made up of the drop in overall gross margin of £68k, increased investment in engineering and development in line with the Company's strategy towards progressing its "game changing" opportunities of £60k and reduced other operating income (principally grant income) £72k, offset by a decrease in income tax credit of £36k and reduction of exceptional item expenses of £72k compared to the prior year.

Looking ahead, our R&D tax credit advisers, Baker Tilly, have advised that we should continue to receive tax credits of between £175k to £200k per annum based on the continued current levels of research activity.

At 31 May 2014, inventory was £271k (2013: £357k). This decrease was as a result of utilisation of stock during the year to support our automotive sales and also relates to the timing of delivery to the motor racing market during the last couple of months of FY2013/14.

Net cash used in operating activities increased by 28% to £501k from £392k last year, mainly due to increased losses after tax (as above), offset by R&D tax credit received of £168k and lower working capital levels at the 2014 year end.

The Company had a cash balance of £151k at 31 May 2014 (2013: £457k).

Loss per share was 1.65p pence (2013: loss 1.71 pence).

Operational review

Surface Transforms is a UK based developer and manufacturer of carbon ceramic products for the automotive and aircraft brakes markets. In these industries our products are lightweight, extremely durable and offer better handling, improved refinement and superior wear life compared to typical automotive iron brakes and for the aerospace industry they offer weight reduction and superior wear life. Our strategy is to firstly establish well engineered products which we sell into the automotive retrofit market. Although this retrofit market is relatively small it allows the Company to generate revenues with the goal of reaching 'cash breakeven' and more importantly reduces the product and supplier risks for the main part of our strategy, which is to work closely with major Tier 1 suppliers and OEMs in the automotive and aerospace markets and introduce our products into these large main stream markets.

The key features of our business model are as follows:

- We engineer and develop carbon ceramic brake products, which deliver high technical performance for both automotive and aerospace brake market opportunities, estimated to, ultimately, be a £1 billion per annum market.
- Our product technology offers technical advantages over our competitors and our process technology offers a highly competitive low cost manufacturing route making our products price competitive with good margins.
- To sell a new disruptive product technology the risks need to be managed. These risks are addressed in partnership with Tier 1 system suppliers and OEMs.
  - We have a growing body of technical data to support product adoption.
  - We are developing our manufacturing capability in terms of operating systems, manufacturing capacity and supply chain management using automotive and aerospace quality standards (TS16949 and AS9100).
- Our products are protected by a high level of intellectual property through a combination of patents and company process know how.

SURFACE TRANSFORMS

Strategic Report

Delivering our objectives:

Product development and engineering has progressed, and we continue to design retrofit products for Porsches, Ferraris, Nissan GTR and tuning companies and are pleased to report no further technical issues in the field have been reported. In addition the automotive OEM market has identified a technical requirement which the Company is addressing. The technical requirement relates to the industry rather than to the Company and therefore offers the Company the opportunity to gain an important competitive advantage in the market place. Our test results have shown that our product can deliver the technical requirements and development work is ongoing to build up the product and process data in partnership with the Tier 1 and OEMs on the 'game changing' programmes.

Our cost reduction programme continues to advance. Last year's introduction of the new CVI plant not only provided much needed additional capacity, but it is now delivering the planned manufacturing cost savings. Our plan to halve the manufacture cost is based on a series of engineering projects which are prioritised according to the needs of the business. Some projects require just engineering time; however others require both engineering time and capital investment similar to the new CVI plant mentioned above. The plan to deliver the full cost reduction programme will also deliver the customer requirements for security of supply, manufacturing capacity and lead time. The company has continued to maintain discussions regarding expansion plans with local enterprise authorises relating to facilities, incentives and grants with detailed planning underway. As previously stated the construction and new equipment contracts will only be signed in parallel with both tangible 'game changer' programme progress and raising the second stage finance required to complete a new factory. The company intends to progress all of these projects during the next 12 months.

In line with OEM requirements for quality and continuous improvement the Company has the objective of becoming a certified automotive and aerospace supplier. These certifications are TS 16949 for the automotive industry and AS 9100 for the aerospace industry. We have implemented a new quality system and operating procedures which will see the Company become a certified TS 16949 supplier during the next 6 to 12 months. In adopting these industry recognised quality practices the Company has assessed the cost of quality within the business and believes substantial savings can be made. This work is therefore not only important in terms of aligning ourselves with our industry partners but also in reaching 'cash breakeven'.

In terms of the development of aircraft brakes we continue our targeted strategy of working with a specific aircraft brake system supplier on an exclusive basis for particular military and light commercial aircraft. The work has expanded from the initial programme of a specific US military aircraft into developing systems for light commercial aircraft. The technical requirements for the military aircraft are very demanding and both companies have been working to resolve the remaining technical issues and believe this is achievable. All the technical data has been submitted for review by the Aerospace OEM and their feedback is expected soon, so as to allow the two companies to determine how to progress the programme to commercialisation. The new programme for light commercial aircraft has successfully completed its feasibility testing and will now progress into the different small aircraft platforms for validation testing and product sign off. The product technology is now understood for this market but similar to the automotive market each aircraft requires engineering approval. The market is therefore more diverse but much larger than the single military aircraft and the key driver for this market is life cycle costs reduction.

Finally the objective of 'cash breakeven' through automotive retrofit sale has not yet been achieved. The change in our route to market from a small number of key distributors to many direct sales contact and the introduction of a German sales office is bearing fruit and we expect to see sales growth return during the next financial year. This new approach has the advantage of being able to reduce the end user price without the Company losing gross margin, reduces the Company's sales risk by not being dependent on key distributors and enables the Company to build its brand and reputation within the automotive community.

Alongside these core business objectives the Company has also:

- Completed a placing in November 2013 for £327k from both institutional and private investors to further progress the Company's objectives towards 'game changing' new business;
- Delivered the technology transfer agreement worth $1 million with a major US clutch and transmission manufacturer. The agreement related to the transfer of one of Surface Transforms' in-house developed process technologies, a technology which is only one stage of Surface Transforms' multi-stage production process for carbon-ceramic brake disc components, and included the sale of specialist equipment;
- Significant growth in its automotive race products with a global major European brake manufacturer. We anticipate the level of sales from these activities to continue to grow, but at a much slower rate during 2014 and 2015.

Strategic Report

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 revised its performance targets during the year in each of these areas:

- Turnover £1.3m (2013: £1.1 million)
- Losses after taxation and exceptional items £674k (2013: £580k)

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

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 by 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.

In summary the Company has seen good progress in its automotive and aircraft 'game changing' projects and increasing sales driven principally by products for the major European brake supplier. The drop in sales in the retrofit market was disappointing but the actions taken during the year will generate retrofit sales growth and it is through this delivery that our objective of short term 'cash break even' can be achieved.

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 progressing well its 'game changing' opportunities. The Board expects continuing sales growth and is confident of making further announcements during the year.

David Bundred
Chairman

Kevin Johnson
Chief Executive

29 August 2014

Directors' Report

The Directors present their annual report and the audited financial statements for the year ended 31 May 2014.

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 and exceptional items amounted to £674k (2013: £580k). The Directors do not recommend the payment of a dividend (2013: £nil).

Political and charitable donations

The Company made no political or charitable donations during the year (2013: £nil).

Directors and Directors' interests

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

D Bundred* (Chairman)
K D'Silva*
Dr K Johnson (Chief Executive)
RD Gledhill*

*denotes non-executive Director.

The Director retiring by rotation is David Bundred.

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	1.97%	833,870	833,870
RD Gledhill	20.82%	8,801,977	8,098,153
Dr K Johnson	0.29%	124,000	124,000
D Bundred	1.14%	483,824	275,000

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 10 and 11.

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

Directors' Report

Substantial shareholders

In addition to the Directors' interests noted on page 7, the Directors are aware of the following who were interested in 3% or more of the Company's equity as at 14 July 2014:

Registered holding	Number of ordinary shares	% of issued share capital
J M Finn & Co	4,608,280	10.90%
Hargreave Hale	3,744.000	8.86%
WH Ireland	1,840,000	4.35%
Investec Wealth & Investment (RS)	1,690,950	4.00%
Dr Richard Emslie	1,558,000	3.69%

Corporate governance

Surface Transforms Plc is committed to maintaining high standards of corporate governance. The Company complies with the UK Corporate Governance 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 the same three non-executive Directors. Details of the Remuneration Committee are disclosed in the report on Directors' remuneration on pages 10 and 11.

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 £674k 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. The detailed cash flow assumptions are based on the company's annual budget, prepared and approved by the Board, which reflects a number of key assumptions including; revenue growth, underpinned by current pipeline; customer compliance with payment terms; other receipts of a value and timing consistent with previous years. Revenues are expected to continue in the forthcoming year.

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 page 3 and the Strategic report on pages 4 to 6. In addition, note 20 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.

Directors' Report

Disclosure of information to auditor

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.

By order of the board

D Bundred
Chairman

29 August 2014

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:

	2014 £	2013 £
Executive directors		
Dr K Johnson	**90,329**	104,092
	90,329	104,092
Non-executive directors		
K D'Silva	**16,550**	16,550
RD Gledhill	**18,000**	18,000
D Bundred	**27,000**	27,000
	61,550	61,550
	151,879	165,642

With the exception of Dr K Johnson, none of the Directors received pension contributions in respect of their office. In addition to the emoluments received, as stated above, Dr K Johnson received £21,000 (2013: £21,000) in respect of pension contributions.

Directors' interests

Details of any contracts in which a Director has a material interest are disclosed in note 18.

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

Report on Directors' Remuneration

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 2013	Granted during the year	Number of Share options expired, waived or lapsed	Holding on 31 May 2014	Exercise Price	Exercise Period	Expiry Date
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	15/02/15-15/03/22	15/02/2022
KA D'Silva	18/04/2007	50,000	–	–	50,000	£0.21	18/04/10-18/04/17	17/04/2017
D Bundred	17/10/2011	100,000	–	–	100,000	£0.09	17/10/14-17/10/21	17/10/2021
D Bundred	17/10/2011	100,000	–	–	100,000	£0.09	17/10/14-17/10/21	17/10/2021
D Bundred	17/10/2011	100,000	–	–	100,000	£0.09	17/10/14-17/10/21	17/10/2021
		1,894,707	–	–	1,894,707			

The market price of the shares at 31 May 2014 was 9.75 pence and during the year varied from 14.25 pence to 6.50 pence.

By order of the board

D Bundred
Chairman

29 August 2014

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

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Strategic Report, the Directors 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 Auditor's Report

to the members of Surface Transforms Plc

We have audited the financial statements of Surface Transforms Plc for the year ended 31 May 2014 set out on pages 14 to 34. 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 12, 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 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 Financial Reporting Council's web-site at www.frc.org.uk/auditscopeukprivate.

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 2014 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 Strategic Report and 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

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

29 August 2014

Statement of Total Comprehensive Income

for the year ended 31 May 2014

	Note	2014 £'000	2013 £'000
Revenue	2	**1,273**	1,059
Cost of sales		**(557)**	(275)
Gross profit		**716**	784
Administrative expenses:			
Before research costs		**(613)**	(601)
Research costs		**(955)**	(895)
Total administrative expenses	3	**(1,568)**	(1,496)
Other operating income	3	**66**	138
Operating loss		**(786)**	(574)
Financial income	6	**–**	2
Financial expenses	6	**(56)**	(68)
Loss before tax and exceptional item		**(842)**	(640)
Exceptional item	7	**–**	(72)
Loss before tax		**(842)**	(712)
Taxation	8	**168**	132
Loss for the year after tax	16	**(674)**	(580)
Other comprehensive income		**–**	–
Total comprehensive loss for the year		**(674)**	(580)
Loss per ordinary share			
Basic and diluted	19	**(1.65p)**	(1.71p)

All amounts relate to continuing activities.

The notes on pages 18 to 34 form part of these financial statements.

Balance Sheet

at 31 May 2014

	Note	2014 £'000	2014 £'000	2013 £'000	2013 £'000
Non-current assets					
Property, plant and equipment	9		**586**		665
Current assets					
Inventories	10	**271**		357	
Trade and other receivables	11	**454**		326	
Cash and cash equivalents		**151**		457	
			876		1,140
Total assets			**1,462**		1,805
Current liabilities					
Other interest bearing loans and borrowings	12	**(9)**		(198)	
Trade and other payables	13	**(395)**		(299)	
		(404)		(497)	
Non Current liabilities					
Other interest bearing loans and borrowings	12	**(418)**		(339)	
Total liabilities			**(822)**		(836)
Net assets			**640**		969
Equity					
Share capital	15		**423**		384
Share premium	16		**7,995**		7,707
Capital reserve	16		**464**		464
Retained loss	16		**(8,242)**		(7,586)
Total equity attributable to equity shareholders of the Company			**640**		969

These financial statements were approved by the board of Directors on 29 August 2014 and were signed on its behalf by:

D Bundred
Director

Dr K Johnson
Director

Company Registered Number 3769702

The notes on pages 18 to 34 form part of these financial statements.

Statement of Changes in Equity

for the year ended 31 May 2014

For the year to 31 May 2014

	Share capital £'000	Share premium account £'000	Capital reserve £'000	Retained loss £'000	Total £'000
Balance at 31 May 2013	384	7,707	464	(7,586)	969
Comprehensive income for the year					
Loss for the year	–	–	–	(674)	(674)
Total comprehensive income for the year	–	–	–	(674)	(674)
Transactions with owners, recorded directly to equity					
Shares issued in the year	39	288	–	–	327
Equity settled share based payment transactions	–	–	–	18	18
Total contributions by and distributions to the owners	39	288	–	18	345
Balance at 31 May 2014	**423**	**7,995**	**464**	**(8,242)**	**640**

For the year to 31 May 2013

	Share capital £'000	Share premium account £'000	Capital reserve £'000	Retained loss £'000	Total £'000
Balance at 31 May 2012	319	7,305	464	(7,034)	1,054
Comprehensive income for the year					
Loss for the year	–	–	–	(580)	(580)
Total comprehensive income for the year	–	–	–	(580)	(580)
Transactions with owners, recorded directly to equity					
Shares issued in the year	65	465	–	–	530
Cost of issue written off to share premium	–	(63)	–	–	(63)
Equity settled share based payments	–	–	–	28	28
Total contributions by and distributions to the owners	65	402	–	28	495
Balance at 31 May 2013	**384**	**7,707**	**464**	**(7,586)**	**969**

The notes on pages 18 to 34 form part of these financial statements.

Cash Flow Statement

for the year ended 31 May 2014

	Note	2014 £'000	2013 £'000
Cash flows from operating activities			
Loss for the year		**(674)**	(580)
Adjusted for:			
Depreciation charge		**91**	83
Loss on sale of property, plant and equipment		**10**	–
Equity settled share-based payment expenses		**18**	28
Financial income		**–**	(2)
Financial expense		**56**	68
Taxation		**(168)**	(132)
		(667)	(535)
Changes in working capital			
Decrease in inventories		**86**	46
(Increase)/decrease in trade and other receivables		**(128)**	31
Increase in trade and other payables		**96**	–
		(613)	(458)
Interest received	6	**–**	2
Interest paid	6	**(56)**	(68)
Taxation received	8	**168**	132
Net cash used in operating activities		**(501)**	(392)
Cash flows from investing activities			
Acquisition of property, plant and equipment	9	**(63)**	(460)
Proceeds from sale of property, plant & equipment		**41**	–
Net cash used in investing activities		**(22)**	(460)
Cash flows from financing activities			
Proceeds from issue of share capital		**327**	468
Proceeds from new loan		**400**	437
Payment of finance lease liabilities		**(6)**	(4)
Repayment of borrowings		**(504)**	(139)
Net cash from financing activities		**217**	762
Net decrease in cash and cash equivalents		**(306)**	(90)
Cash and cash equivalents at the beginning of the period		**457**	547
Cash and cash equivalents at the end of the period		**151**	457

The notes on pages 18 to 34 form part of these financial statements.

Notes to the Financial Statements

for the year ended 31 May 2014

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 29 August 2014.

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 £674k 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. The detailed cash flow assumptions are based on the company's annual budget, prepared and approved by the Board, which reflects a number of key assumptions including; revenue growth, underpinned by current pipeline; customer compliance with payment terms; other receipts of a value and timing consistent with previous years. Revenues are expected to continue in the forthcoming year.

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 page 3 and the Strategic report on pages 4 to 6. In addition, note 20 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.

1 Accounting policies continued

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.

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.

Notes to the Financial Statements

1 Accounting policies continued

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.

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, which are typically received in September, 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 and from the sale of technology rights during the course of the year. 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.

Interest-bearing borrowings
Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method less any impairment losses.

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 shareholders 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.

Notes to the Financial Statements

1 Accounting policies continued

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.

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 2014 and which will have a significant impact on the information reported by the company in future periods.

Notes to the Financial Statements

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 as 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 and the development of technologies associated with this.

	2014 Total £'000	**2013 Total £'000**
Segment results		
Segment revenues	**1,273**	1,059
Operating expenses	**(2,125)**	(1,771)
Other income	**66**	138
Results from operating activities	**(786)**	(574)
Net finance costs	**(56)**	(66)
Loss before tax and exceptional item	**(842)**	(640)
Segment assets/liabilities		
Segment assets	**1,462**	1,805
Segment liabilities	**(822)**	(836)

The Company considers it offers product technology namely carbon fibre re-enforced ceramic material, which is machined into differing shapes depending on the intended purpose of the end user.

Revenue by geographical destination is analysed as follows:

	2014 £'000	**2013 £'000**
United Kingdom	**129**	291
Rest of Europe	**657**	392
United States of America	**465**	376
Rest of World	**22**	–
	1,273	1,059

Turnover comprises £1,013k of product sales (2013: £759k) and £260k in relation to the sale of technology (2013: £300k).

Notes to the Financial Statements

3 Expenses and auditors remuneration

	2014 £'000	2013 £'000
Operating loss is stated		
after charging		
Depreciation of owned tangible fixed assets	91	83
Research costs expensed as incurred	965	895
Rents payable under operating leases – land and buildings	55	55
Rents payable under operating leases – other	–	6
Exchange losses	2	6
Loss on PPE disposal	10	–
Inventory write down	51	42
Impairment loss on receivable	12	18
after crediting		
Exchange gains	12	2
Government grants	66	138

Auditor's remuneration

Amounts receivable by auditors and their associates in respect of:

	2014 £'000	2013 £'000
Audit of these financial statements	21	18
All other services	1	2

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 £151,879 (2013: £165,642). Of this £90,329 (2013: £104,092) was made to the highest paid Director and Company pension contributions of £21,000 (2013: £21,000) 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.

Notes to the Financial Statements

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 2014	2013
Directors	**4**	4
Other employees	**17**	18
	21	22

The aggregate payroll costs of these persons were as follows:

	2014 £'000	2013 £'000
Wages and salaries	**625**	607
Social security costs	**66**	64
Other pension costs (see note 17)	**44**	50
	735	721

6 Financial income and expenses

	2014 £'000	2013 £'000
Finance income		
Bank interest receivable	**–**	2
Finance expenses		
Total interest expense on financial liabilities measured at amortised cost	**56**	68

7 Exceptional item

Exceptional item comprises:

	2014 £'000	2013 £'000
Restructure of Sales department and costs incurred	**–**	72

8 Taxation

	2014 £'000	2013 £'000
Analysis of credit in year		
UK corporation tax		
Research and development tax repayment	**(168)**	(132)
Total income tax credit	**(168)**	(132)

Details of the unrecognised deferred tax asset are included in note 14.

Factors affecting the tax credit for the current period

The current tax credit for the year is lower (2013: lower) than the standard rate of corporation tax in the UK of 22.67% (2013: 23.83%). The differences are explained below:

	2014 £'000	2013 £'000
Reconciliation of effective tax rate		
Loss for the year	**(674)**	(580)
Total income tax credit	**(168)**	(132)
Loss excluding income tax	**(842)**	(712)
Current tax at average rate of 22.67% (2013: 23.83%)	**(191)**	(170)
Effects of:		
Non-deductible expenses	**7**	7
Change in unrecognised timing differences	**20**	(33)
Current year losses for which no deferred tax recognised	**164**	196
Tax incentives	**(168)**	(132)
Income tax credit (see above)	**(168)**	(132)

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.

Reductions in the UK corporation tax rate from 23% to 21% (effective from 1 April 2014) were substantively enacted on 2 July 2013. This will reduce the company's future current tax credit accordingly and reduce the deferred tax asset at 31 May 2014 which has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

9 Property, plant and equipment

	Leasehold improvements £'000	Plant and machinery £'000	Fixtures and fittings £'000	Total £'000
Cost				
At 31 May 2012	75	512	55	642
Additions	–	451	9	460
Disposals	–	–	–	–
At 31 May 2013	75	963	64	1,102
Additions	–	62	1	63
Disposals	–	(179)	–	(179)
At 31 May 2014	**75**	**846**	**65**	**986**
Depreciation				
At 31 May 2012	36	276	42	354
Charge for year	8	69	6	83
Charge on disposal	–	–	–	–
At 31 May 2013	44	345	48	437
Charge for year	8	76	7	91
Charge on disposal	–	(128)	–	(128)
At 31 May 2014	**52**	**293**	**55**	**400**
Net book value				
At 31 May 2012	39	236	13	288
At 31 May 2013	31	618	16	665
At 31 May 2014	**23**	**553**	**10**	**586**

At 31 May 2014 the net carrying amount of leased plant and machinery was £33,556 (2013: £36,833).

10 Inventories

	2014 £'000	2013 £'000
Raw materials and consumables	**35**	63
Work in progress	**166**	225
Finished goods	**70**	69
	271	357

Raw materials, consumables and changes in finished goods and work in progress recognised as cost of sales in the year amounted to £556,568 (2013: £274,906).

11 Trade and other receivables

	2014 £'000	2013 £'000
Trade receivables	**357**	230
Other receivables	**46**	51
Prepayments and accrued income	**51**	45
	454	326

All receivables fall due within one year.

12 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 20.

	2014 £'000	2013 £'000
Current liabilities		
Loans	–	191
Finance lease liabilities	**9**	7
Non-current liabilities		
Loans	**400**	313
Finance lease liabilities	**18**	26

On the 28 March 2014 the company took out a loan facility for £400,000 from Group 14 Limited, a related party (see note 18). Fees of £5,000 were incurred. These have been deferred within other receivables and will be amortised over the life of the loan. The loan incurs interest at a rate of 9.5% above base rate, payable monthly in arrears. Repayments commence at a rate of £8,500 per month on 28 March 2017. No covenants are attached to the facility. Pre-existing loans were repaid in full at the same date.

The finance lease is in relation to a motor vehicle being used as part of the research & development programme. The interest rate is at an annual rate of 8.5% payable over a period of 36 months.

Finance lease liabilities are payable as follows:

	Future minimum lease payments 2014 £'000	Interest 2014 £'000	Present value of minimum lease payments 2014 £'000	Future minimum lease payments 2013 £'000	Interest 2013 £'000	Present value of minimum lease payments 2013 £'000
Less than one year	**11**	**2**	**9**	10	3	7
Between one and five years	**20**	**2**	**18**	30	4	26
	31	**4**	**27**	40	7	33

13 Trade and other payables: amounts falling due within one year

	2014 £'000	2013 £'000
Trade payables	**260**	196
Taxation and social security	**21**	15
Accruals and deferred income	**114**	88
	395	299

Notes to the Financial Statements

14 Deferred tax

	2014 £'000	2013 £'000
Difference between accumulated depreciation and amortisation and capital allowances	**(5)**	41
Other short term timing differences	**–**	(1)
Tax losses	**(658)**	(774)
Unrecognised deferred tax asset	**(663)**	(734)

The elements of the deferred taxation are as follows:

The Company has an unrecognised deferred tax asset at 31 May 2014 of £663,000 (2013: £734,000) 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.

15 Called up share capital

	2014 £'000	2013 £'000
Allotted, called up and fully paid		
42,278,636 shares of £0.01 each (2013: 38,435,138 shares of £0.01 each)	**423**	384

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 10 and 11. In addition to the Directors' share options, certain employees and former directors have been granted the following options:

Date of grant	Number of unexpired share options at year end	Exercise price	Exercise period
17/04/2007	180,000	£0.20	18/04/10-18/04/17
30/06/2008	180,200	£0.18	30/06/11-30/06/18
22/09/2008	353,766	£0.19	22/09/11-22/09/18
01/02/2010	145,000	£0.09	01/03/13-01/03/20
15/02/2012	106,696	£0.12	15/03/15-15/03/22
02/08/2013	200,000	£0.10	02/08/16-02/08/24

There are a total of 988,443 unexpired options held by employees, a total of 1,894,707 unexpired options held by Directors and 177,219 unexpired options held by former directors.

16 ## Share premium and reserves

	Share premium account £'000	Capital reserve £'000	Retained deficit £'000
At 31 May 2012	7,305	464	(7,034)
Retained loss for the year	–	–	(580)
Share issue	465	–	–
Costs of issue written off to share premium	(63)	–	–
Equity settled share based payment transactions	–	–	28
At 31 May 2013	7,707	464	(7,586)
Retained loss for the year	–	–	(674)
Share issue	288	–	–
Costs of issue written off to share premium	–	–	–
Equity settled share based payment transactions	–	–	18
At 31 May 2014	**7,995**	**464**	**(8,242)**

17 ## 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 £43,497 (2013: £50,572). 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 £17,576 of the pension contributions (2013: £25,965).

There were outstanding contributions of £1,366 (2013:£1,498) at the end of the financial year.

18 ## Related party disclosures

Transactions with key management personnel

Directors of the Company and their immediate relatives control 24.23% per cent of the voting shares of the Company. At present employees and Directors would hold 28.71% of the share capital, following the exercise of all outstanding share options.

The company considers key management personnel as defined in IAS 24 "Related party disclosures" to be the Directors of the company. The compensation of Directors is disclosed in the Directors Remuneration Report on pages 10 and 11.

Other related party transactions

On 28 March 2014, a loan facility of £400,000 was provided by Group 14 Limited. Due to the presence of a common Board Director, Group 14 is a related party of Surface Transforms Plc.

The loan incurs interest at a rate of 9.5% above base rate, payable monthly in arrears. Repayments commence at a rate of £8,500 per month 3 years after the first draw down. No covenants are attached to the facility. Details of transactions in the year and year end balances are disclosed below.

	2014 £000	2013 £000
Transactions in the year:		
Group 14		
Interest paid	7	–
Fees paid	5	–
	12	–
Balances (payable)/receivable:		
Group 14 loan payable	(400)	–

19 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	2014	2013
Loss after tax (£'000)	**(674,016)**	(579,526)
Weighted average number of shares (No. of shares)	**40,730,707**	33,915,972
Loss per share (pence)	**(1.65p)**	(1.71p)

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.

20 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 2014			31 May 2013	
	US Dollar £'000	Euro £'000	Sterling £'000	US Dollar £'000	Euro £'000	Sterling £'000
Cash and cash equivalents	**13**	**20**	**118**	20	9	428
Trade receivables	**43**	**–**	**314**	–	41	189
Trade payables	**(29)**	**(1)**	**(230)**	(13)	–	(183)
Finance lease liabilities	**–**	**–**	**(27)**	–	–	(33)
Net exposure	**27**	**19**	**175**	7	50	401

	Average Rate		Reporting Date Spot Rate	
	2014	2013	2014	2013
US Dollar	**1.684**	1.569	**1.675**	1.531
Euro	**1.231**	1.218	**1.229**	1.179

Sensitivity Analysis

A ten percent strengthening of the pound against the US Dollar and the Euro at 31 May 2014 would have decreased 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 2013.

	US Dollar £'000	Euro £'000
31 May 2014	**(2)**	**(2)**
31 May 2013	(1)	(5)

A ten percent weakening of the pound against the US Dollar and the Euro at 31 May 2014 would have an equal and opposite effect to the amounts shown above, on the basis all other variables remain constant.

20 Financial instruments continued

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.

Credit Risk

The Company operates a closely monitored collection policy.

The ageing of trade receivables at the reporting date was:

	31 May 2014			31 May 2013		
	Gross £'000	Impairment £'000	Net £'000	Gross £'000	Impairment £'000	Net £'000
Not past due	**201**	**–**	**201**	127	–	127
Past due 0 to 30 days	**121**	**–**	**121**	51	–	51
Past due 31 to 90 days	**46**	**(11)**	**35**	70	(18)	52
	368	**(11)**	**357**	248	(18)	230

There was an amount of £10,618 (2013: £18,353) 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 12.

Interest Rate Risk

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

	2014 £'000	2013 £'000
Fixed rate instruments		
Finance lease liabilities	**27**	33
Loan	**400**	504

The Company has cash deposits of £1,660 (2013: £310,331) 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 Natwest base rate of 0.5% (2013: 0.5% Barclays). The interest rates applicable to finance lease liabilities and loans is disclosed in note 12.

20 Financial instruments continued

Fair values of the Company's financial assets and liabilities

The table below analyses financial instruments, into a fair value hierarchy based on the valuation technique used to determine fair value.

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value of financial assets and liabilities as follows:

	2014 Level 1 £'000	2014 Level 2 £'000	2014 Level 3 £'000	2013 Level 1 £'000	2013 Level 2 £'000	2013 Level 3 £'000
Financial assets:						
Cash and cash equivalents	–	151	–	–	457	–
Loans and receivables:						
Trade receivables	–	357	–	–	230	–
Total financial assets	–	508	–	–	687	–
Financial liabilities at amortised cost:						
Trade payables	–	(260)	–	–	(196)	–
Loans	–	(400)	–	–	(504)	–
Finance lease liabilities	–	(27)	–	–	(33)	–
Total financial liabilities	–	(687)	–	–	(733)	–

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.

Notes to the Financial Statements

21 Commitments

Non-cancellable operating lease rentals are payable as follows:

	Land and buildings 2014 £'000	Motor vehicles 2014 £'000	Land and buildings 2013 £'000	Motor vehicles 2013 £'000
Within one year	**55**	**–**	55	6
In the second to fifth years inclusive	**96**	**–**	150	4
	151	**–**	205	10

Capital commitments as at 31 May 2014 were £nil (2013: £nil).

22 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 2013	Granted	Surrendered	Lapsed	At 31 May 2014	Exercise price	Date from which exercisable	Expiry date
(a)	280,000	–	–	–	280,000	£0.21	18/04/2010	18/04/2017
(b)	50,000	–	–	–	50,000	£0.21	18/04/2010	18/04/2017
(a)	468,200	–	12,000	–	456,200	£0.18	30/06/2011	30/06/2018
(b)	12,000	–	–	–	12,000	£0.18	22/09/2013	22/09/2018
(a)	632,035	–	10,000	–	622,035	£0.19	30/06/2011	30/06/2018
(b)	213,438	–	–	–	213,438	£0.19	22/09/2011	22/09/2018
(a)	170,000	–	25,000	–	145,000	£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	17/10/2014	17/10/2021
(b)	100,000	–	–	–	100,000	£0.09	17/10/2014	17/10/2021
(b)	100,000	–	–	–	100,000	£0.09	17/10/2014	17/10/2021
(a)	131,696	–	25,000	–	106,696	£0.12	15/02/2015	15/03/2022
(b)	330,000	–	–	–	330,000	£0.12	15/02/2015	15/03/2022
(a)	–	200,000	–	–	200,000	£0.10	02/08/2016	02/08/2023
Total	2,932,369	200,000	72,000	–	3,060,369			

(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 their options during employment with the Company.

22 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 2012	1,771,931	0.17	1,250,438	0.12
Granted	–	–	–	–
Forfeited & surrendered	(90,000)	–	–	–
Outstanding at 31 May 2013	1,681,931	0.18	1,250,438	0.12
Granted	200,000	0.10	–	–
Forfeited & surrendered	(72,000)	–	–	–
Outstanding at 31 May 2014	1,809,931	0.17	1,250,438	0.12
Range of exercise prices	9p to 21p		9p to 21p	

Weighted average remaining contractual life for the EMI Scheme is 4 years 11 months (2013: 5 years 11 months).

Weighted average remaining contractual life for the unapproved Scheme is 6 years 4 months (2013: 7 years 4 months).

There were no share options exercised during the year (2013 nil).

A charge of £17,821 (2013:£27,687) 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	2014	2013
Fair value per share option	**11.4p**	10.19p
Share price on date of grant	**10.0p**	11.5p
Exercise price	**10.0p**	11.5p
Share options granted in the year – EMI scheme	**200,000**	–
Share options granted in the year – Unapproved scheme	**–**	–
Expected volatility	**100%**	100%
Exercise pattern (years)	**3-10 years uniformly**	3-10 years uniformly
Expected dividend yields	**0%**	0%
Risk free rate of return	**2%**	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.

Company Information and Advisers

Websites	www.surfacetransforms.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	**David C Allen**
Address	Unit 4 Olympic Park Poole Hall Road Ellesmere Port Cheshire CH66 1ST Tel: 0151 356 2141
Nominated adviser	**Cantor Fitzgerald Europe** One Churchill Place Canary Wharf London E14 5RB
Brokers	**Cantor Fitzgerald Europe** One Churchill Place Canary Wharf London E14 5RB
Auditors	**KPMG LLP** St James' Square Manchester M2 6DS
Solicitors to the Company	**Gateley LLP** Ship Canal House, 98 King Street, Manchester, M2 4WU
Bankers	**NatWest** Chester Branch 33 Eastgate Street Chester CH1 1LG **Barclays Bank Ltd** 125 Main Street Frodsham Cheshire WA6 7AD
Registrars	**Capita Asset Services** The Registry 34 Beckenham Road 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 Cantor Fitzgerald Europe, One Churchill Place, Canary Wharf, London E14 5RB, on 30 September 2014 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 2014 together with the last Directors' report, the last Directors' remuneration report and the auditors' report on those accounts.
2. To re-elect D Bundred, 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 LLP as auditors for the Company to hold office from the conclusion of this meeting until the conclusion of the next annual general meeting 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 £140,928 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 £140,928 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."

Notice of Annual General Meeting

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

   "THAT, subject to and conditional upon the passing of the resolution numbered 4 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 4 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 £42,278, 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

David C Allen
Company Secretary

Date: 29 August 2014

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

Notice of Annual General Meeting

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 Asset Services at PXS, Beckenham, Kent BR3 4TU by 11.00 am on 28 September 2014. 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 Asset Services at PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU by 11.00 am on 28 September 2014.
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 Asset Services (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 6.00 pm on 28 September 2014 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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