KleenAir Systems International plc

Financial statements

For the period from 16 March 2004 to 31 December 2004

Grant Thornton

Company No. 5075088

Officers and professional advisers

Company registration number	5075088
Registered office	22 Grove Farm Park Northwood HA6 2BQ
Directors	L Simons - Chairman T W E Downes MBE P M Newell A M Rentoul
Secretary	P M Keane FCA
Bankers	Barclays Bank PLC Level 27 One Churchill Place London E14 5HP
Solicitors	Dechert LLP 2 Serjeants' Inn London EC4Y 1LT
	Henmans 116 St Aldates Oxford OX1 1HA
Auditors	Grant Thornton UK LLP Chartered Accountants Registered Auditors Churchill House Chalvey Road East Slough Berkshire SL1 2LS

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Chairman's statement

I am delighted to be writing to you as chairman in this, our first annual report. In October 2004 we published a prospectus seeking to raise money for the company and I am pleased to say we raised over £850,000 in new share capital. We now have 53 shareholders.

You will note from the financial statements that we have not yet traded at a profit. This is in line with our expectations and was anticipated at the time you subscribed for your shares. Since I wrote to you on 17 February 2005 there have been three important developments which will have a material effect on our business.

1. On March 15 the Public Carriage Office (PCO) announced a one year delay, to July 2006, in the implementation of the Taxi Programme to upgrade to Euro III emission standard all taxis licenced for hire in London and not already meeting that standard. At that time a total of some 11,000 vehicles will be required to be upgraded over the following year, with a further 5,300 in the year beginning July 2007. While no reason was given for this delay, we speculate that there was no technology other than your company's available which could meet the emissions standards and that this was not acceptable to the PCO. While this is disappointing in the short term and will have a significant impact on revenues for 2005, it will enable your company further to prove its technology in a PCO test programme during the six month period July-December 2005. We are confident of the results and of the publicity likely to be derived from them.

2. Your company has been in detailed discussion with Transport for London (TfL) who will be responsible for the administration of the London Low Emission Zone (LEZ), due for implementation in October 2007. Final work on the plan is still under way and a TfL announcement is not expected until the autumn. While it would be wrong for me to speculate on the outcome of the TfL deliberations, it is known that there is strong political support for the scheme within London and support from the stakeholders who would be involved, including the freight transport industry which will be most affected. Your directors continue to believe that the introduction of a London LEZ would provide an important market for the company's products and would be likely to lead to the introduction of LEZs in other major metropolitan areas in the UK and possibly within other EU countries. Once again, as with the congestion charging scheme, London may break new ground.

3. An opportunity is under discussion in China which would enable the company to achieve significant market entry there. A letter of understanding has been signed with a major supplier to the automotive industry which could lead to significant business developing in the latter part of 2006.

I am pleased to advise that your company has recruited an extremely experienced and well qualified Technical Director. Karl Grimston has spent the past four years with Delphi Diesel Systems working on emissions solutions and prior to that spent six years in the same field with Engelhard Corporation both in the UK and the USA. His brief is to consolidate your company's technological know how in the UK and to work closely with our partners, in particular with Dinex A/S in Denmark and Dinex Exhausts Limited in Warrington.

The directors believe that it is appropriate that Mr Grimston should be given the opportunity to invest in the company by means of an option over shares of the company in order that his commitment to and success in driving up the value of the company may be appropriately rewarded. The directors are therefore taking the opportunity of the forthcoming annual general meeting to propose to the members the adoption of a share option scheme. This is the subject of a separate circular being sent to shareholders today. The board proposes that the first grant of an option under the scheme will be to Mr Grimston in the 2005 financial year.

I should like to thank my three fellow directors for the considerable guidance and advice they have given since incorporation in both the fundraising activities and the commercial development of the company.

Lionel Simons
Chairman
30 June 2005

Report of the directors

The directors present their report and the financial statements of the group for the period from 16 March 2004 to 31 December 2004.

Principal activities and business review

The company was incorporated on 16 March 2004.

The principal activity of the group during the period was the development of vehicle emission reduction devices. The company acquired the entire share capital of KleenAir Systems International Inc. and thereby its subsidiary KleenAir Systems Limited on 14 April 2004.

Results and dividends

The trading results for the period and the group's financial position at the end of the period are shown in the attached financial statements.

The directors have not recommended a dividend.

The directors and their interests

The directors who served the company during the period together with their beneficial interests in the shares of the company were as follows:

		Ordinary Shares	
		At 31 December 2004	**At 16 March 2004**
		£0.01 each	**£1 each**
L Simons	(Appointed 16 March 2004)	**–**	–
T W E Downes MBE	(Appointed 16 March 2004)	**800,000**	–
P M Newell	(Appointed 16 March 2004)	**400,000**	1
A M Rentoul	(Appointed 16 March 2004)	**400,000**	1

Policy on the payment of creditors

It is the company's policy to settle the terms of payment with suppliers when agreeing the terms of the transaction, to ensure that suppliers are aware of these terms and to abide by them. Trade creditors at the period end amounted to 47 days of average supplies for the period.

Directors' responsibilities

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the group at the end of the period and of the group's profit or loss for the period then ended. In preparing those financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records, for safeguarding the assets of the group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

Grant Thornton UK LLP were appointed during the financial year and offer themselves for reappointment as auditors in accordance with section 385 of the Companies Act 1985.

BY ORDER OF THE BOARD

P M Keane

P M Keane FCA
Secretary
30 June 2005

Grant Thornton

Report of the independent auditors to the members of KleenAir Systems International plc

We have audited the financial statements of KleenAir Systems International plc for the period from 16 March 2004 to 31 December 2004 which comprise the accounting policies, group profit and loss account for the period ended 31 December 2004, group balance sheet and company balance sheet, group cash flow statement for the period ended 31 December 2004 and notes 1 to 16. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the report of the directors and the financial statements in accordance with United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the report of the directors is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We read other information contained in the Chairman's statement and the report of the directors and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of opinion

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

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

Report of the independent auditors to the members of KleenAir Systems International plc (continued)

Going Concern

In forming our opinion, we have considered the adequacy of the disclosures made on page 10 of the financial statements concerning the delay in the implementation of the Taxi Programme by the Public Carriage Office and the need to seek further funding to compensate for the one year delay. In view of the significance of this uncertainty we consider that it should be drawn to your attention, but our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 December 2004 and of the loss of the group for the period then ended, and have been properly prepared in accordance with the Companies Act 1985.

Grant Thornton UK LLP

GRANT THORNTON UK LLP
REGISTERED AUDITORS
CHARTERED ACCOUNTANTS
LONDON THAMES VALLEY OFFICE
SLOUGH
30 June 2005

Principal accounting policies

Basis of accounting

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

Going concern

On March 15 2005 the Public Carriage Office announced a one year delay in the implementation of the Taxi Programme to upgrade to Euro III emission standard all taxis licenced for hire in London and not already meeting that standard. This programme would have required some 11,000 vehicles to be upgraded over the following year, with a further 5,300 in the year commencing July 2007. While no reason was given for the delay, it will have a significant impact on the group's forecast revenues for 2005 resulting in the need for further finance to be raised.

The directors are now in the process of speaking to advisers with a view to raising further equity finance from existing shareholders and potential investors.

The directors consider that, in preparing the financial statements, they have taken into account all information that could reasonably be expected to be available. On this basis, they consider that it is appropriate to prepare the financial statements on the going concern basis. This assumes that the necessary finance will be raised by KleenAir Systems International plc which will in turn finance the business for the foreseeable future. The financial statements do not include any adjustments that would result if the raising of finance were not successful.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and all group undertakings. These are adjusted, where appropriate, to conform to group accounting policies. Acquisitions are accounted for under the acquisition method and goodwill on consolidation is capitalised and amortised from the year of acquisition. The results of companies acquired are included in the profit and loss account after the date that control passes. As a consolidated profit and loss account is published, a separate profit and loss account for the parent company is omitted from the group financial statements by virtue of section 230 of the Companies Act 1985.

Related party transactions

The company is the parent company of the group and consolidated accounts have been prepared. Accordingly, the group has taken advantage of the exemption in Financial Reporting Standard 8 "Related Party Transactions" from disclosing transactions with members of the group.

Research and development

Research and development expenditure is written off in the year in which it is incurred.

Amortisation

Amortisation is calculated so as to write off the cost of an asset over the useful economic life of that asset as follows:

Goodwill - 10 years

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax except that deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Foreign currencies

Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are translated into sterling at the rate of exchange ruling at the date of the transaction. Exchange differences are taken into account in arriving at the operating profit.

Investments

Investments are recorded at cost less amounts written off.

Group profit and loss account for the period ended 31 December 2004

	Note	9 month period ended 31 Dec 04 £
Group turnover		–
Other operating charges	2	**250,643**
Loss on ordinary activities before taxation		**(250,643)**
Tax on loss on ordinary activities	5	–
Loss for the financial period	6	**(250,643)**

All of the activities of the company are classed as continuing.
The company has no recognised gains or losses other than the results for the period as set out above.

The company has taken advantage of section 230 of the Companies Act 1985 not to publish its own Profit and Loss Account.

Group balance sheet

	Note	31 Dec 04 £
Fixed assets		
Intangible assets	7	**147,611**
Current assets		
Debtors	9	**44,920**
Cash at bank		**95,924**
		140,844
Creditors: amounts falling due within one year	10	**118,422**
Net current assets		**22,422**
Total assets less current liabilities		**170,033**
Capital and reserves		
Called-up equity share capital	12	**100,000**
Other reserves	13	**320,676**
Profit and loss account	13	**(250,643)**
Shareholders' funds	14	**170,033**

These financial statements were approved by the directors on 30 June 2005 and are signed on their behalf by:

L Simons

Balance sheet

	Note	31 Dec 04 £
Fixed assets		
Investments	8	**99,990**
Current assets		
Debtors	9	**319,574**
Cash at bank		**1,112**
		320,686
Total assets		**420,676**
Capital and reserves		
Called-up equity share capital	12	**100,000**
Other reserves	13	**320,676**
Shareholders' funds		**420,676**

These financial statements were approved by the directors on 30 June 2005 and are signed on their behalf by:

L Simons

Group cash flow statement for the period ended 31 December 2004

	Note	9 month period ended 31 Dec 04 £
Net cash outflow from operating activities	15	**(227,892)**
Acquisitions and disposals		
Acquisition of shares in group undertakings		**3,130**
Net cash inflow from acquisitions and disposals		**3,130**
Cash outflow before financing		**(224,762)**
Financing		
Issue of equity share capital		**10**
Unissued share capital paid		**320,676**
Net cash inflow from financing		**320,686**
Increase in cash		**95,924**

Reconciliation of net cash flow to movement in net funds

		31 Dec 04 £
Increase in cash in the period		**95,924**
Movement in net funds in the period		**95,924**
Net funds at 16 March 2004	15	**-**
Net funds at 31 December 2004	15	**95,924**

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

Notes to the financial statements

1 Turnover

The group has not traded in this accounting period hence no turnover is disclosed.

2 Other operating income and charges

	9 month period ended 31 Dec 04 £
Administrative expenses	250,643

3 Operating loss

Operating loss is stated after charging:

	9 month period ended 31 Dec 04 £
Amortisation	16,401
Auditors' remuneration:	
Audit fees	11,950

4 Particulars of employees

Directors' fees of £28,530 were paid to Mr A M Rentoul for his services as a director of the group. No salaries or wages were paid to employees, including the remainder of the directors, during the period.

5 Taxation on loss on ordinary activities

Due to the losses in the year, no corporation tax liability has arisen.

5 Taxation on loss on ordinary activities (continued)

Factors affecting current tax charge

The tax assessed on the loss on ordinary activities for the period is higher than the standard rate of corporation tax in the UK of 19%.

	9 month period ended 31 Dec 04 £
Loss on ordinary activities before taxation	(250,643)
Profit/(loss) on ordinary activities by rate of tax	(47,622)
Utilisation of tax losses	47,622
Total current tax	–

6 Profit attributable to members of the parent company

The profit dealt with in the accounts of the parent company was £Nil.

7 Intangible fixed assets

Group	Goodwill £
Cost	
Additions	164,012
At 31 December 2004	164,012
Amortisation	
Charge for the period	16,401
At 31 December 2004	16,401
Net book value	
At 31 December 2004	147,611

8 Investments

Company	Group companies £
Cost	
Additions	99,990
At 31 December 2004	99,990
Net book value	
At 31 December 2004	99,990

8 Investments (continued)

At 31 December 2004 the company held 100% of the ordinary share capital of the following undertakings:

Profit and (loss) for the year

	31 December 2004 £
KleenAir Systems International Inc. (100% Direct)	nil
KleenAir Systems Limited (100% Indirect)	(281,021)

Capital and reserves

	31 December 2004 £
KleenAir Systems International Inc. (100% Direct)	19,724
KleenAir Systems Limited (100% Indirect)	(328,474)

KleenAir Systems International Inc. is incorporated and registered in the Bahamas. KleenAir Systems Limited is incorporated and registered in England and Wales.

9 Debtors

	The group £	The company £
Amounts owed by group undertakings	–	319,564
VAT recoverable	16,803	–
Other debtors	3,310	10
Prepayments and accrued income	24,807	–
	44,920	319,574

10 Creditors: amounts falling due within one year

	The group £	The company £
Trade creditors	41,260	–
Other creditors	61,683	–
Accruals and deferred income	15,479	–
	118,422	–

11 Related party transactions

During the period, consultancy fees of £20,239 were paid to Osney Consulting Limited, a company in which Mr P M Newell a director, has a controlling interest.

No other transactions with related parties were undertaken such as are required to be disclosed under Financial Reporting Standard 8 "Related Party Transactions".

12 Share capital

Authorised share capital:

	31 Dec 04
	£
25,000,000 Ordinary shares of £0.01 each	**250,000**

Allotted, called up and fully paid:

	No	£
Ordinary shares of £0.01 each	**10,000,000**	**100,000**

The company was incorporated with an authorised share capital of £100,000 represented by 100,000 ordinary shares of £1 each of which two were issued to subscribers.

On 16 March 2004, 49,998 ordinary shares of £1 each in the capital of the company were applied for by Lionel Simons against his irrevocable undertaking to pay up a quarter of the amount of their nominal value in consideration for the company's agreement to include his name in the register of members at his request at any time prior to the execution of the Share Exchange Agreement referred to below. After the execution of the Share Exchange Agreement, in accordance with the terms of the undertaking the allotment to Lionel Simons referred to in this paragraph was cancelled.

On 14 April 2004, by written resolutions of the company the 100,000 ordinary shares of £1 each in the capital of the company were consolidated into 20,000 ordinary shares of £5 each in the capital of the company and the authorised share capital of the company was increased from £100,000 to £250,000 by the creation of an additional 30,000 ordinary shares of £5 each in the capital of the company.

On 14 April 2004, the company entered into the Share Exchange Agreement with the persons named in the first schedule to the Share Exchange Agreement (the "Vendors"), pursuant to which the company acquired the entire issued share capital of KleenAir Systems International Inc. in exchange for the allotment and issue to the Vendors of 19,998 ordinary shares of £5 each in the capital of the company pro rata to their holdings in KleenAir Systems International Inc.

On 5 October 2004, by written resolution of the company the 50,000 ordinary shares of £5 each in the capital of the company were sub-divided into 25,000,000 ordinary shares of £0.01 each in the capital of the company.

On 5 October 2004, by written resolution of the company the directors were generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 to allot relevant securities of an aggregate nominal value equal to the authorised but unissued share capital of the company, such authority expiring on 5 October 2009 unless revoked or renewed before that date. The directors were also empowered, pursuant to section 95 of the Act, to allot equity securities (within the meaning of section 94(2) of the Act) for cash as if section 89(1) of the Act did not apply to such allotment up to an aggregate nominal amount equal to the authorised but unissued share capital of the company, such authority expiring on 5 October 2009 unless revoked or renewed before that date.

13 Reserves

Group	Shares to be issued £	Profit and loss account £
Loss for the period	–	(250,643)
Other movements		
Equity shares to be issued	320,676	–
At 31 December 2004	320,676	(250,643)

Company	Shares to be issued £	Profit and loss account £	Total shareholders' funds £
Other movements			
Equity shares to be issued	320,676	–	320,676
At 31 December 2004	320,676	–	320,676

As at the period end, the company had received £536,694 in relation to shares which had been subscribed and paid for before the period end but were issued on 10 February 2005. Costs of £216,018 had also been incurred which qualify for allocation against share premium. The costs have therefore been set off against the shares to be issued as the total amount received includes £518,804 which has since the period end been classified as share premium when the shares were issued.

14 Reconciliation of movements in shareholders' funds

	31 Dec 04 £
Loss for the financial period	(250,643)
New equity share capital subscribed	100,000
Equity shares to be issued	320,676
	420,676
Net addition to shareholders' equity funds	170,033
Closing shareholders' equity funds	170,033

15 Notes to the statement of cash flows

Reconciliation of operating loss to net cash outflow from operating activities

	9 month period ended 31 Dec 04
	£
Operating loss	(250,643)
Amortisation	16,401
Increase in debtors	(38,737)
Increase in creditors	45,087
Net cash outflow from operating activities	(227,892)

Analysis of changes in net funds

	At 16 Mar 2004	Cash flows	At 31 Dec 2004
	£	£	£
Net cash:			
Cash in hand and at bank	–	95,924	95,924
Net funds	–	95,924	95,924

16 Acquisitions and Disposals

On 14 April 2004 the company acquired 100% of the share capital of KleenAir Systems International Inc. for a consideration of £99,990 satisfied by the issue of 19,998 ordinary shares of £5 (later subdivided into 9,999,000 ordinary shares of £0.01). Goodwill arising on the acquisition of KleenAir Systems International Inc. and its subsidiary has been capitalised. The assets and liabilities of the acquired business were included within the company's balance sheet at their fair values at the date of acquisition.

The loss after taxation of KleenAir Systems International Inc. and subsidiary for the period from 1 January 2004, the beginning of the KleenAir Systems International Inc. and its subsidiary's financial year to the date of acquisition was £43,080. The loss after taxation for the year ended 31 December 2003 was £29,657.

The assets and liabilities of KleenAir Systems International Inc. group acquired were as follows:

	Book value £	**Fair value £**
Current assets		
Debtors	6,183	6,183
Bank & cash	3,130	3,130
Total assets	9,313	9,313
Creditors		
Trade creditors	15,710	15,710
Other creditors	57,625	57,625
Total liabilities	73,335	73,335
Purchased goodwill capitalised		164,012
		99,990
Satisfied by:		
Issue of shares		99,990

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

	2004 £
Net cash outflow from operating activities	324,752

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

	2004 £
Cash at bank and in hand acquired	3,130