KleenAir Systems International plc

Financial statements

For the year ended 31 December 2005

Company No. 05075088

Officers and professional advisers

Company registration number	05075088
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
Bankers	Barclays Bank PLC Level 27 One Churchill Place London E14 5HP
Solicitors	Dechert LLP 160 Queen Victoria Street London EC4V 4QQ
	Henmans 116 St Aldates Oxford OX1 1HA
Auditor	Grant Thornton UK LLP Chartered Accountants Registered Auditors Churchill House Chalvey Road East Slough SL1 2LS

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Chairman's statement

The past year has seen some significant steps forward in preparing the company for the commercialisation of its emissions reduction technologies.

In August 2005, the company acquired all the intellectual property rights previously owned exclusively by KleenAir Systems Inc. in the US, and of which the company was a licensee. This provides a firmer foundation for the company for future technological advances stemming from effective development and exploitation of these patents.

While we have not yet traded at a profit, this is in line with our expectations. With the one year delay by the Public Carriage Office of implementation of the taxi upgrade programme until July 2006, as indicated in my previous report, revenue was effectively delayed until the coming year. The good news is that the company's products have been performing very well in the new round of tests implemented by the Energy Savings Trust.

In the meantime, systems were installed during the year for field trials on 24 sightseeing buses in London and 36 light commercial vehicles in Glasgow. This has enabled the company to collect data on operating performance in the field and to reconfigure the field maintenance and support requirements in partnership with our licensee Dinex A/S.

The company has had continued discussions with Transport for London (TfL), who will be responsible for the administration of the London Low Emission Zone (LEZ). This has now been rescheduled for implementation in 2008. Final work on the plan is still under way. TfL has announced a public consultation on an implementation proposal by Deloitte. This will begin this month. While it would be wrong for me to speculate on the outcome of the TfL deliberations, it is understood that there is strong political support for the scheme within the Greater London Authority and the government (including the Department for Transport). In addition, at least eight other urban authorities have indicated interest in following the LEZ model.

The 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 LEZ's 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.

The opportunity referred to in my last report with regard to China has resulted in a contract, with a significant supplier to the Chinese automotive industry, to manufacture one of the company's patented products and distribute it in China. It is expected that this product and others which are currently under test and evaluation in China may lead to revenues within the foreseeable future.

The directors believe the time is right to proceed with a public offering on the Alternative Investment Market and plans for this are well under way.

I should like to thank my three fellow directors for the considerable guidance and advice they have continued to give as we prepare for the commercial development of the company.

Lionel Simons
Chairman
3 February 2006

Report of the directors

The directors present their report and the financial statements of the group for the year ended 31 December 2005.

Principal activities and business review

The principal activity of the group during the year was the development of vehicle emission reduction devices.

The review of the business is included in the Chairman's statement on page 4.

Results and dividends

The trading results for the year and the group's financial position at the end of the year 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 year together with their beneficial interests in the shares of the company were as follows:

	Ordinary Shares of £0.01 each	
	At 31 December 2005	At 1 January 2005
L Simons	-	-
T W E Downes MBE	820,000	800,000
P M Newell	420,000	400,000
A M Rentoul	420,000	400,000

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 18 days of average supplies for the period (2004: 47).

Directors' responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

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 and of the profit or loss of the group for that year. 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.

Auditor

Grant Thornton UK LLP 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
Secretary

3 February 2006

Grant Thornton

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

We have audited the group and parent company financial statements ("the financial statements") of KleenAir Systems International plc for the year ended 31 December 2005 which comprise the principal accounting policies, group profit and loss account, group balance sheet and company balance sheet, group cash flow statement 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 auditor's 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

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

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

We report to you our opinion as to whether the 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 other transactions 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 international standards on auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the 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 and company's circumstances, consistently applied and adequately disclosed.

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

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.

Opinion

In our opinion:

the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the group's and the parent company's affairs as at 31 December 2005 and of the loss of the group for the year then ended; and

the financial statements have been properly prepared in accordance with the Companies Act 1985.

Emphasis of Matter - Going Concern

In forming our opinion, which is not qualified, we have considered the adequacy of the disclosures made on page 9 of the financial statements concerning the group's ability to continue as a going concern. The group incurred a net loss of £438,101 during the year ended 31 December 2005 and, at that date, the group's current liabilities exceed its current assets by £149,490. These conditions, along with the other matters explained on page 9 of the financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the company was unable to continue as a going concern.

Grant Thornton UK LLP

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

3 February 2006

Principal accounting policies

Basis of accounting

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

Following the one year delay of the taxi upgrade programme announced by the Public Carriage Office in 2005, the group's revenue was effectively delayed until 2006. In order to provide sufficient financing for the foreseeable future, the group is seeking a public offering if its shares on the Alternative Investment Market with a view to raise no less than £1m. To further support the working capital requirements of the ongoing business, the directors are also in discussions to arrange an invoice discounting facility that will provide up to £0.5m in funds.

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 Alternative Investment Market listing will be successful and the invoice discounting facility will be arranged. The financial statements do not include any adjustments that would result if these finance raising exercise's are not successful.

The principal accounting policies, which remain unchanged from the previous period, are set out below.

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 Disclosures' from disclosing transactions with members of the group.

Turnover

The turnover shown in the group profit and loss account represents amounts receivable during the year, exclusive of Value Added Tax.

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
Intellectual property rights	- 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 differ ences 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

	Note	Year to 31 Dec 05 £	Period from 16 Mar 04 to 31 Dec 04 £
Group turnover	1	**8,961**	–
Other operating charges	2	**451,658**	250,643
Operating loss	3	**(442,697)**	(250,643)
Interest receivable		**4,596**	–
Loss on ordinary activities before taxation		**(438,101)**	(250,643)
Tax on loss on ordinary activities	6	–	–
Loss for the financial year	7	**(438,101)**	(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 year 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	2005 £	2004 £
Fixed assets			
Intangible assets	8	**227,877**	147,611
Current assets			
Debtors	10	**54,056**	44,920
Cash at bank		**46,846**	95,924
		100,902	140,844
Creditors: amounts falling due within one year	11	**250,392**	118,422
Net current (liabilities)/assets		**(149,490)**	22,422
Total assets less current liabilities		**78,387**	170,033
Capital and reserves			
Called-up equity share capital	13	**129,438**	100,000
Share premium account	14	**637,693**	–
Other reserves	14	**–**	320,676
Profit and loss account	14	**(688,744)**	(250,643)
Shareholders' funds	15	**78,387**	170,033

These financial statements were approved by the directors on 3 February 2006 and are signed on their behalf by:

L Simons

Company balance sheet

	Note	2005 £	2004 £
Fixed assets			
Intangible assets	8	**96,667**	–
Investments	9	**99,990**	99,990
		196,657	99,990
Current assets			
Debtors	10	**658,683**	319,574
Cash at bank		**31,894**	1,112
		690,577	320,686
Creditors: amounts falling due within one year	11	**125,064**	–
Net current assets		**565,513**	320,686
Total assets less current liabilities		**762,170**	420,676
Capital and reserves			
Called-up equity share capital	13	**129,438**	100,000
Share premium account	14	**637,693**	–
Other reserves	14	**–**	320,676
Profit and loss account	14	**(4,961)**	–
Shareholders' funds		**762,170**	420,676

These financial statements were approved by the directors on 3 February 2006 and are signed on their behalf by:

L Simons

Group cash flow statement

	Note	Year to 31 Dec 05 £	Period from 16 Mar 04 to 31 Dec 04 £
Net cash outflow from operating activities	16	**(300,129)**	(227,892)
Returns on investments and servicing of finance			
Interest received		4,596	–
Net cash inflow from returns on investments and servicing of finance		4,596	–
Capital expenditure			
Payments to acquire intangible fixed assets		(100,000)	–
Net cash (outflow) from capital expenditure		(100,000)	–
Acquisitions and disposals			
Acquisition of shares in group undertakings		–	3,130
Net cash inflow from acquisitions and disposals		–	3,130
Cash outflow before financing		**(395,533)**	(224,762)
Financing			
Issue of equity share capital		29,438	10
Share premium on issue of equity share capital		637,693	–
Unissued share capital (deducted)/paid		(320,676)	320,676
Net cash inflow from financing		346,455	320,686
Decrease in cash		**(49,078)**	95,924

Reconciliation of net cash flow to movement in net funds

		2005 £	2004 £
(Decrease)/increase(in cash in the period		(49,078)	95,924
Movement in net funds in the period		(49,078)	95,924
Net funds at 1 January 2005	16	95,924	–
Net funds at 31 December 2005	16	46,846	95,924

Notes to the financial statements

1 Turnover

Group turnover represents income from products and services that have been delivered to customers.

2 Other operating charges

	Year to 31 Dec 05 £	Period from 16 Mar 04 to 31 Dec 04 £
Administrative expenses	**451,658**	250,643

3 Operating loss

Operating loss is stated after charging/(crediting):

	Year to 31 Dec 05 £	Period from 16 Mar 04 to 31 Dec 04 £
Amortisation	**19,734**	16,401
Auditor's remuneration:		
Audit fees	**17,950**	11,950
Net profit on foreign currency translation	**(303)**	–

4 Particulars of employees

The average number of staff employed by the group during the financial year amounted to:

	Year to 31 Dec 05	Period from 16 Mar 04 to 31 Dec 04
	No	No
Number of management staff	1	–
Executive director	1	1
Non executive directors	3	3

The aggregate payroll costs of the above were:

	Year to 31 Dec 05	Period from 16 Mar 04 to 31 Dec 04
	£	£
Wages and salaries	108,336	–
Social security costs	6,485	–
	114,821	–

5 Directors

Remuneration in respect of directors was as follows:

	Year to 31 Dec 05	Period from 16 Mar 04 to 31 Dec 04
	£	£
Emoluments receivable	75,000	–

In addition to directors' emoluments shown, £35,534 was paid to Osney Consulting Limited for the consultancy services of Mr Newell (2004: £20,239). No additional fees for consultancy services were paid to Mr Rentoul during the year (2004: £28,530).

6 Taxation on loss on ordinary activities

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

6 Taxation on loss on ordinary activities (continued)

Factors affecting current tax charge

The tax assessed on the loss on ordinary activities for the year is higher than the standard rate of corporation tax in the UK of 19% (2004 - 19%).

	Year to 31 Dec 05 £	Period from 16 Mar 04 to 31 Dec 04 £
Loss on ordinary activities before taxation	**(432,101)**	(250,643)
Loss on ordinary activities by rate of tax	**(83,239)**	(47,622)
Unrelieved tax losses	**83,239**	47,622
Total current tax	**-**	-

7 Loss attributable to members of the parent company

The loss dealt with in the accounts of the parent company was £(4,961) (2004 - £Nil).

8 Intangible fixed assets

Group	**Goodwill £**	**Intellectual property rights £**	**Total £**
Cost			
At 1 January 2005	164,012	–	164,012
Additions	–	100,000	100,000
At 31 December 2005	**164,012**	**100,000**	**264,012**
Amortisation			
At 1 January 2005	**16,401**	**–**	**16,401**
Charge for the year	**16,401**	**3,333**	**19,734**
At 31 December 2005	**32,802**	**3,333**	**36,135**
Net book value			
At 31 December 2005	**131,210**	**96,667**	**227,877**
At 31 December 2004	147,611	–	147,611

8 Intangible fixed assets (continued)

Company	**Intellectual property rights**
	£
Cost	
Additions	100,000
At 31 December 2005	**100,000**
Amortisation	
Charge for the year	3,333
At 31 December 2005	3,333
Net book value	
At 31 December 2005	96,667
At 31 December 2004	–

9 Investments

Company	**£**
Cost	
At 1 January 2005 and 31 December 2005	99,990
Net book value	
At 31 December 2005	99,990
At 31 December 2004	99,990

At 31 December 2005 KleenAir Systems International plc held 100% of the issued ordinary share capital of the companies listed below.

	Country of incorporation	**Proportion of share capital held**	**Nature of business**
KleenAir Systems International Inc.	Bahamas	100%(Direct)	Non-trading holding company
KleenAir Systems Limited	England and Wales	100%(Indirect)	Trading

10 Debtors

	The group		The company	
	2005	2004	**2005**	2004
	£	£	**£**	£
Trade debtors	**20,011**	–	–	–
Amounts owed by group undertakings	–	–	**658,679**	319,564
VAT recoverable	–	16,803	**4**	–
Other debtors	**14,315**	3,310	–	10
Prepayments and accrued income	**19,730**	24,807	–	–
	54,056	44,920	**658,683**	319,574

11 Creditors: amounts falling due within one year

	The group		The company	
	2005	2004	**2005**	2004
	£	£	**£**	£
Trade creditors	**21,386**	41,260	–	–
Other creditors	**40,893**	7,241	**24,999**	–
Amounts owed to related undertakings	**119,011**	54,442	**100,000**	–
Accruals and deferred income	**69,102**	15,479	**65**	–
	250,392	118,422	**125,064**	–

12 Related party transactions

During the year, consultancy fees of £35,534 (2004:£20,239) were paid to Osney Consulting Limited, a company in which Mr P M Newell a director, has a controlling interest. As at 31 December 2005, £6,550 remained outstanding (2004:£nil).

During the year, £55,298 (2004:£Nil) was paid to KleenAir Systems Inc. for services rendered and costs recharged, a company in which Mr L Simons, a director, has an interest. During the period KleenAir Systems Inc. transferred to KleenAir Systems International plc intangible assets for a consideration of £100,000. At the end of the period, the total group balance payable to KleenAir Systems Inc. amounted to £119,011.

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

13 Share capital

Authorised share capital:

	2005 £	2004 £
25,000,000 Ordinary shares of £0.01 each	250,000	250,000

Allotted, called up and fully paid:

	2005 No	£	2004 No	£
Ordinary shares of £0.01 each	12,943,833	129,438	10,000,000	100,000

Allotments during the year

The company made an allotment of 2,943,833 ordinary £0.01 shares at £0.30 per share by way of offer for subscription. The difference between the total consideration of £667,131 (net of issue costs of £216,018) and the total nominal value of £29,438 has been credited to the share premium account.

14 Reserves

Group	Share premium account £	Shares to be issued £	Profit and loss account £
At 1 January 2005	–	320,676	(250,643)
Loss for the year	–	–	(438,101)
Other movements			
New equity share capital subscribed	637,693	–	–
- transfer to other reserves	–	(320,676)	–
At 31 December 2005	637,693	–	(688,744)

Company	Share premium account £	Shares to be issued £	Profit and loss account £
At 1 January 2005	–	320,676	–
Loss for the year	–	–	(4,961)
Other movements			
New equity share capital subscribed	637,693	–	–
- transfer to other reserves	–	(320,676)	–
At 31 December 2005	637,693	–	(4,961)

14 Reserves (continued)

As at 31 December 2004, the company had received £536,694 in relation to shares which had been applied and paid for before the year but were issued on 10 February 2005. Costs of £216,018, which qualify for allocating against share premium, had also been incurred as at 31 December 2004. These costs have therefore been set off against the shares to be issued as it includes £518,804 of share premium.

As at 31 December 2005, £17,890 of this balance had been transferred to share capital and £302,786 to the share premium account.

15 Reconciliation of movements in shareholders' funds

	2005	2004
	£	£
Loss for the financial year	**(438,101)**	(250,643)
New equity share capital subscribed	**29,438**	100,000
Premium on new share capital subscribed	**637,693**	–
Transfer (to)/from share capital and share premium	**(320,676)**	320,676
Net (reduction)/addition to shareholders' funds	**(91,646)**	170,033
Opening shareholders' funds	**170,033**	–
Closing shareholders' funds	**78,387**	170,033

16 Notes to the statement of cash flows

Reconciliation of operating loss to net cash outflow from operating activities

	Year to 31 Dec 05	Period from 16 Mar 04 to 31 Dec 04
	£	£
Operating loss	**(442,697)**	(250,643)
Amortisation	**19,734**	16,401
Increase in debtors	**(9,136)**	(38,737)
Increase in creditors	**131,970**	45,087
Net cash outflow from operating activities	**(300,129)**	(227,892)

16 Notes to the statement of cash flows (continued)

Analysis of changes in net funds

	At 1 Jan 2005	Cash flows	At 31 Dec 2005
	£	£	£
Net cash:			
Cash in hand and at bank	95,924	(49,078)	46,846
Net funds	95,924	(49,078)	46,846