

# Modern Water plc

Annual Report and Accounts 2014

Company Number 5963927

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[www.modernwater.com](http://www.modernwater.com)

Modern Water owns a portfolio of water technologies to address the limited availability of fresh water and the treatment and disposal of wastewater worldwide. By 2025, it is forecast that two-thirds of the world's population will live in countries classified as water-stressed. Climate change is likely to further exacerbate this situation.

Managed by an executive team with extensive experience in the water industry, Modern Water is at the leading edge of new and developing technologies, products and services, which are vital to the future sustainability of the world's most precious commodity.

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# Business at a Glance

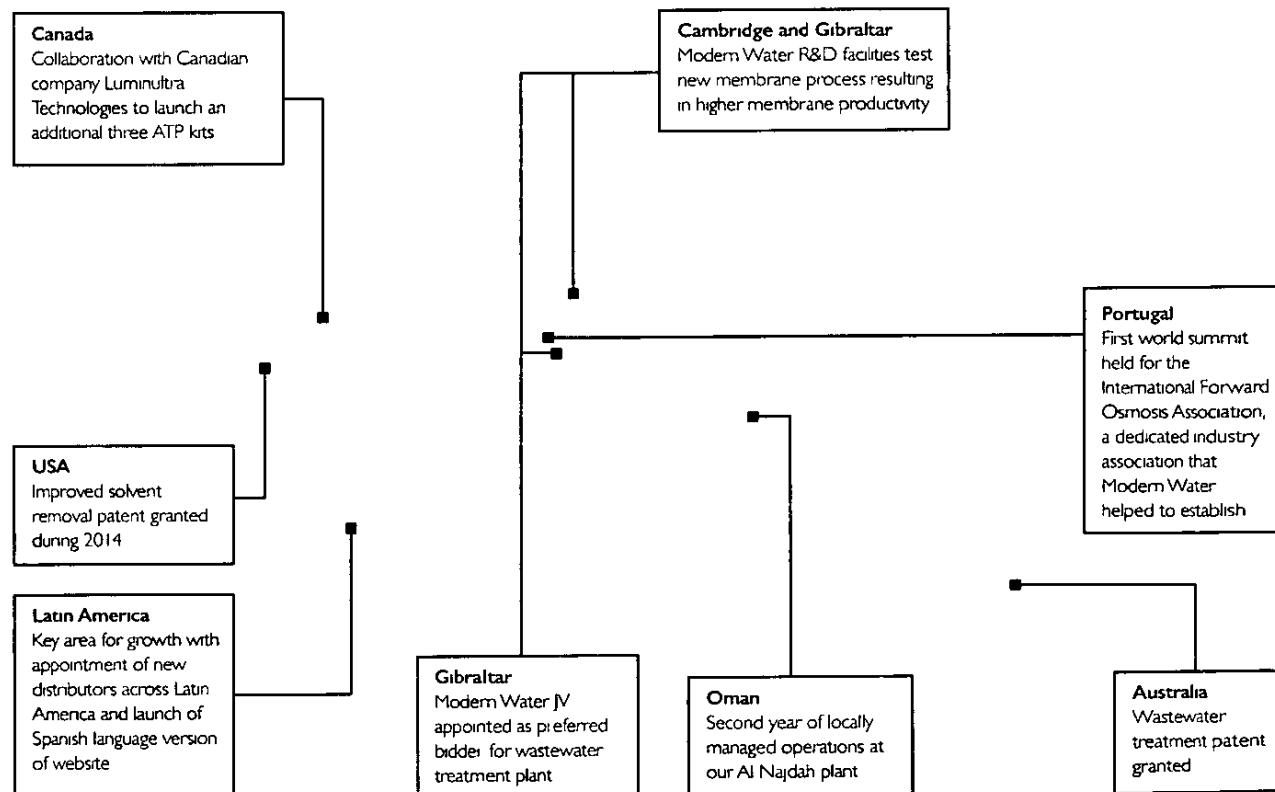
Modern Water owns, installs and operates broad based membrane systems using world-leading membrane technologies; supplies packaged seawater Reverse Osmosis (RO) desalination systems; supplies wastewater treatment solutions, and develops and supplies advanced systems for water monitoring

## Membrane Processes Division

- FO Desalination (Municipal)
- Thermal Desalination (Industrial)
- Evaporative Cooling Systems (Industrial)
- Membrane Brine Concentration (Industrial)
- Packaged SWRO Desalination Systems & Industrial)
- Wastewater Treatment (Municipal)
- Electro-coagulation

## Monitoring Division

- Trace Metal Products
- Toxicity Products
- Environmental Products



# Chairman's Statement

## Robert Clarke Interim Non-Executive Chairman

Having recently stepped up into the role of Interim Non-Executive Chairman I am pleased to be able to report on the performance of Modern Water for the year ended 31 December 2014

As announced at the end of the year, Neil McDougall who co-founded Modern Water in 2006 stepped down as Executive Chairman effective as at 31 December 2014. At the Group's current stage of development Modern Water has moved to a more conventional Non-Executive Chairman model. We are currently searching for a permanent candidate to fill the role and I will remain in the position of Interim Non-Executive Chairman until that time. I have worked with Modern Water since 2010 as Non-Executive Director and Chairman of the Audit Committee.

Simon Humphrey, the Chief Executive Officer, has set out the main highlights of the year in the Strategic Report and the Group Performance and Financial Review so it leaves me the opportunity to provide a brief overview.

The past year has proved to be one of mixed fortunes for Modern Water. The Company was appointed as the preferred bidder for a wastewater treatment contract worth £22m in Gibraltar, the Company's first significant contract in this field. Assuming this contract is successfully executed, it will provide a strong reference point of credibility for the business going forward, as well as significant revenues and positive cash flow. Disappointingly, the slow-down in China - a key market for both our Membrane and Monitoring divisions - has caused revenues in both divisions to be lower than forecast and below the prior year.

During the year, Modern Water repositioned its Membrane Processes division as a membrane systems specialist, offering a wide variety of water treatment solutions. Our intention is that this will provide a more predictable flow of opportunities with industrial customers which could help to mitigate the lumpy and elongated nature of municipal contracts in the Middle East and China. In view of the time that it is taking to close commercial

“Modern Water was appointed as the preferred bidder for a wastewater treatment contract worth £22m.”

contracts in the Membrane division, and the market capitalisation of Modern Water plc at the year end, the Directors have decided to record a significant non-cash impairment to goodwill and intangibles in the Membrane Division.

The Monitoring division should benefit in 2015 from orders which were deferred from 2014, as well as the availability of new products, notably the Continuous Toxicity Monitor whose delayed release adversely impacted 2014. However, the market in China is expected to remain challenging.

Other highlights of the year included the launch of the AquaPak range of packaged desalination plants, the establishment of the International Forward Osmosis Association and the Monitoring division being awarded its largest ever single contract to supply a purpose built containerised monitoring system.

The Group's financial position remains debt free, with cash of £6.8m as at 31 December 2014.

On behalf of the Board I would like to thank all the team at Modern Water for their ongoing commitment to developing the company and to delivering long term value to our shareholders. We look forward to 2015 which is set to be a key year in the company's development.

**Robert Clarke**  
Interim Non-Executive Chairman  
11 March 2015

# Strategic Report

**Simon Humphrey**  
Chief Executive Officer

The Directors of Modern Water plc (Modern Water or the Company) and its subsidiary undertakings (which together comprise the Group) present their Strategic Report for the year ended 31 December 2014

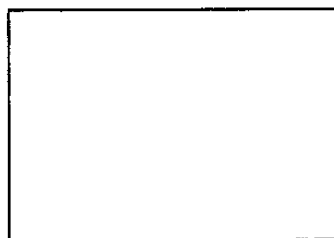
## Principal Activities

Modern Water plc is the holding company of a trading group, the principal activities of which are to own, develop and supply technologies, products and services related to the provision of fresh water and treatment and disposal of waste water, specifically:

- design, construction, testing, installation, commissioning and operation of desalination plants, water cooling systems and brine concentration plants
- packaged seawater desalination systems,
- wastewater treatment systems and electro-coagulation wastewater treatment systems,
- water quality monitoring, environmental monitoring and soil testing

## Key Markets

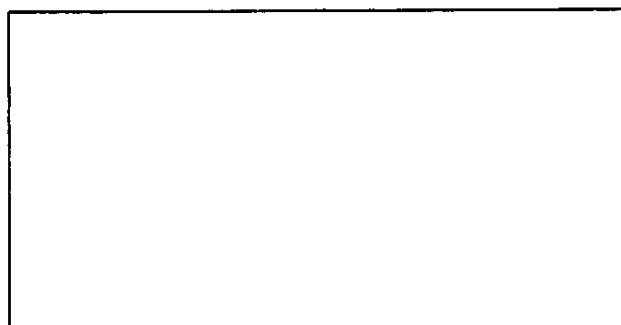
It was a difficult 12 months for Modern Water due to a slow-down in China, one of the Company's key markets for both membrane and monitoring products. During 2014 China saw its weakest growth in 24 years and, whilst we remain well placed to gain further contracts in China, contract negotiations are currently taking longer than anticipated.



With the slow-down in Asia Pacific we have expanded our focus to other markets. Since 2009 Modern Water has been active in Gibraltar and currently has state-of-the-art forward osmosis pilot facilities on the peninsula. In October the Government of Gibraltar

appointed the Modern Water / Northumbrian Water Joint Venture (JV) as preferred bidder for a wastewater treatment plant where we would be the lead contractor. The JV is currently in negotiations with the Government of Gibraltar over the detailed terms of the project which we look forward to updating the market on.

The Monitoring division has also been adversely affected by the slow-down in China with revenue lower than forecast during 2014. Demand for our monitoring products has, however, picked up in other areas of the world. Latin America has been a key area for growth for Modern Water in 2014. In order to support our expansion in this region we launched a Spanish language version of our website in July and have appointed a number of new distributors in many countries across Latin America which we anticipate will lead to an increase in sales in 2015.



## Key Performance Indicators

At the company's current stage of development, the Directors consider that strategic and operational progress is best measured by achievement in terms of technical and business development milestones. Key milestones against which progress was made in 2014, and on which we will focus on making further progress during 2015 were:

- the focused deployment of wastewater technologies including our appointment as preferred bidder by the Government of Gibraltar for the construction of a state-of-the-art wastewater treatment plant
- key relationships strengthened in the Middle East, with our plant at Al Najdah in Oman completing its second year of locally managed operations
- the Monitoring division continued to expand its product portfolio with over ten new products being launched, numerous new distributor agreements signed and new routes to market through industry catalogues established

Objectives not completed in 2014 but which we will again focus on during 2015 include:

- agreement of, and delivery on, the final contract for the Xugong Island project
- entry into the industrial market in China
- progress on projects with Kazema in Kuwait

Further details of strategic and operational progress for the two main operating divisions are outlined in the Membrane Processes and Monitoring sections of this Strategic Report. The Board reviews strategic, operational and financial information on a monthly basis to measure progress. The key financial performance indicators for 2014 covered in more detail in the Financial Review and main financial statement, were:

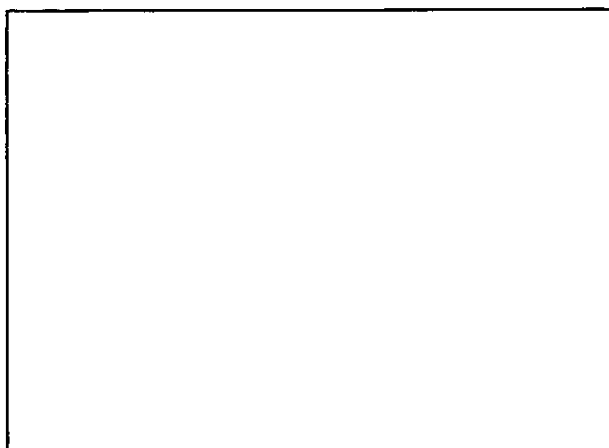
- revenue decreased to £2.8m (2013: £3.5m). At constant exchange rates revenue for the year was £2.9m
- gross profit decreased to £1.2m (2013: £1.7m),
- operating loss before exceptional items, tax, interest, depreciation and amortisation increased to £4.5m (2013: £4.0m)
- loss for the year £17.7m (2013: £4.7m) after exceptional items £12.8m (2013: nil),
- cash outflow, excluding fund raise proceeds increased to £4.6m (2013: £3.9m),
- cash as at 31 December 2014 was £6.8m (2013: £11.4m)

Further information on the financials is detailed in the Financial Review section of this Strategic Report.

# Membrane Process Division

## Operational Review

Year on year revenues from the Membrane Process division increased during 2014. The division successfully completed its second year of operations at the Al Najdah forward osmosis (FO) desalination plant, which is now 100% locally managed.



In terms of Research and Development (R&D) relating to the development of our core FO technology a number of key objectives were completed in 2014 resulting in improvements to the FO membrane efficiency. The membranes were tested over the course of six months at both our Cambridge and Gibraltar R&D testing facilities and it has been successfully proven to lead to a substantially higher rate of productivity. We continue to work on the development of our FO technology.

Modern Water continues to be a pioneer in forward osmosis and in May 2014 our technology was featured on the 50th anniversary edition of one of the UK's most prestigious science programmes BBC Horizon. The BBC presenter Professor Iain Stewart visited Modern Water's first forward osmosis pilot plant in Gibraltar and demonstrated how FO can help alleviate the growing pressure on the planet's fresh water by creating an environmentally sustainable desalination technology.

Another significant development for Modern Water and forward osmosis was the launch of the International Forward Osmosis Association in April 2014. The association was set up by four key companies involved in forward osmosis to promote the technology throughout industry and academia and to provide a voice and a platform for its members. The association held its first world summit in September 2014, an event which attracted significant interest from the membrane industry. As a result of the summit's popularity the association will hold another larger event in September 2015.



## Growth Strategy

The membrane business has recently been repositioned as a broad-based membrane systems company. Over the past few years the technology has developed beyond the original forward osmosis sea water desalination concept. Whilst municipal forward osmosis is still a very significant part of the product portfolio we now have the capability to offer additional products in membrane brine concentration, thermal desalination and evaporative cooling systems as well as packaged sea water reverse osmosis (RO) systems.

During 2014 Modern Water also launched a range of packaged seawater RO desalination plants branded as AquaPak, which vary from 100 to 1,000 cubic metres per day. All units are suitable for a variety of applications including potable or industrial temporary or emergency water supply, construction site water supply, the oil and gas industry as well as golf resorts or hotel complexes. We expect to see sales from these packaged plants start to materialise in 2015.

In view of the time that it is taking to close commercial contracts for forward osmosis, and the market capitalisation of Modern Water plc at the year-end, the Directors decided to record a significant non-cash impairment to goodwill and intangibles in the Membrane Division. The costs associated with filing patents for forward osmosis continue to be held at cost as patents continue to be successfully granted.

## Patent Portfolio

Our patent portfolio continued to strengthen in 2014, with patents granted in new territories across a number of different patent families including the granting of the improved solvent removal process in the USA. The Membrane Process division holds 96 granted patents across eight main patent families of solvent removal, improved solvent removal, secondary oil recovery, osmotic energy, separation process, evaporative cooling, cooling tower improvements and thermal desalination.

An additional patent was granted for wastewater treatment in August 2014 which now brings the total of Modern Water's innovative wastewater treatment patents to six.

## Wastewater Treatment

The Wastewater Treatment section of the Membrane Processes division has made significant progress during the year. In October the Government of Gibraltar appointed a Joint Venture between Modern Water Services Limited and Northumbrian Services Limited as preferred bidder for a wastewater treatment plant, demonstrating Modern Water's ability to progress in large competitive tenders.

The contract will include the design, build, finance and operation of a wastewater treatment plant capable of treating urban wastewater for the entire population of Gibraltar as well as storm flows. Modern Water would be the lead contractor and undertake the design and build of the treatment plant with a current contract value of approximately £22m.

# Monitoring Division

## Operational Review

The Monitoring division achieved sales of £2.7m in 2014 (2013 £3.5m). The downturn in sales was largely due to the slow-down in China, however the remainder of Asia did see a slight increase in sales during the year and the division has a strong order book for 2015. Recurring revenues of service contracts and reagent sales remained constant at £1m in 2014. Gross profit decreased to £1.2m (2013 £1.7m).

The Monitoring division received its largest ever order to date during 2014 for a purpose-built containerised trace metal monitoring system in the Middle East for a large multinational company. This marks a step-change in the Monitoring division's activities as it will be Modern Water's first purpose-built unit of this kind and one which shows our ability to supply fully containerised monitoring systems anywhere in the world. The unit was completed as at 31 December 2014, and held in stock. Once the Final Acceptance Testing is completed in 2015, the unit will be sold to the customer and recognised in revenue.

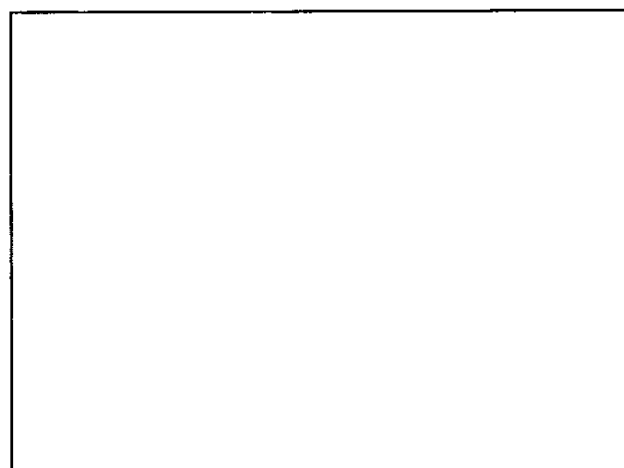
## New Product Development

2014 was an exciting year for new product development with the Monitoring division launching more than ten new products across the toxicity trace metal and environmental ranges. Key new products launched included:

- immunoassay strip tests which can be carried out much more rapidly than currently available test kits,
- ATP environmental kit co-branded with Canadian company Luminultra Technologies Ltd,
- new UV digester to complement our trace metal products,
- new hydrocarbon monitor,
- expanded our range of algal toxin kits
- Microtox® Continuous Toxicity Monitor (CTM)

We expect to see the new product lines translate into additional sales revenue during 2015. The most eagerly awaited new product has been the upgraded Microtox® CTM on trial during 2014 at water treatment plants in the UK, Europe, USA and South Korea. Demand for this

"The Monitoring Division launched more than ten new products across the toxicity trace metal and environmental ranges"



ground-breaking monitor has been high with the first unit being installed just after its launch at a water treatment plant owned by Aqua America Inc in Pennsylvania, USA. The Microtox® CTM is unique as it is the only online toxicity monitor that continuously monitors and provides customers with the potential for real-time analysis. The product has produced excellent results and has received excellent feedback from customers. We are now looking at trialling the monitor for other drinking water applications and wastewater.

## Distributor Network

We have continued to expand our routes to market in both new and existing geographies around the world. This has been done through signing distribution and agency agreements in new countries and territories, the featuring of our products in key industry catalogues, as well as the launch of our website in Spanish to target the Latin American market.

We are constantly reviewing the effectiveness of our distribution network and in early 2014 took the decision to reorganise our sales process throughout the Americas by appointing additional distributors and resellers to effectively cover the whole of this region. In the USA a number of new resellers were appointed to increase the Monitoring division's presence across all 52 States.

# Group Performance and Financial Review

## Intellectual Property

The Group now holds 120 granted patents (2013 115) with 43 pending applications (2013 55). The Membrane Processes division holds 96 granted patents (2013 85) across eight main patent families of solvent removal, improved solvent removal, secondary oil recovery, osmotic energy, separation process, evaporative cooling, cooling tower improvements and thermal desalination. The Monitoring division currently holds 18 granted patents (2013 25) and the Wastewater division currently holds six granted patents (2013 5). During 2014, 13 new patents were granted across nine different patent families. Eight patents expired.

## Resources

Modern Water strives to create a community, not just a workplace, and makes an effort to encourage collaboration and networking across the Group. We also support the ongoing development of our employees and have an excellent track record in staff retention.

Our strategy of employing local workers where we operate continued during 2014, especially in Oman where our operations continue to be 100% locally managed with support from our central technical team. Both our Membrane Processes and Monitoring divisions have adopted this strategy, which is working well.

During 2014, we strengthened our Membrane Processes, Monitoring and Wastewater Treatment teams in order to implement our growth strategy and improve the Group's long-term performance.

As at 31 December, the Group employed 52 permanent staff, supplemented by contract staff as required.

## Financial Review

### Summary

The Group had £6.8m cash in the bank and no debt at 31 December 2014 (2013 £11.4m cash). During the year, the Group continued to incur losses, reflecting that it is in the early stage of commercial roll-out prior to securing significant sales contracts, particularly in the Membrane division. Loss before exceptional items, interest, tax, depreciation and amortisation increased to £4.5m (2013 £4.0m). The increase on the prior year losses was primarily due to a reduction in revenue and gross profit. The Group generated revenue of £2.8m in 2014 (2013 £3.5m), with the reduction primarily due to lower sales into China. The Group incurred exceptional costs of £12.8m, being the non-cash impairment of intangible assets in the Membrane division and costs associated with the resignation of the Executive Chairman and the departure of one other member of staff; consequently, total comprehensive loss increased to £17.7m (2013 £4.7m).

## Cash Flows

The Group cash outflow, excluding fund-raising proceeds for the year, was £4.6m (2013 £3.9m). This increase in cash burn was due to a £0.5m reduction in gross profit and working capital movement during the year (£0.2m).

Cash inflow from interest was £0.1m (2013 £0.1m). Cash outflows comprised £0.1m on property, plant and equipment (2013 £0.1m), £0.1m patents (2013 £0.1m) and £4.5m operating activities (2013 £3.7m).

## Accounting Policies

The Group financial statements have been prepared in accordance with EU Endorsed IFRS, IFRS Interpretations Committee (IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The key accounting policies to note are those concerned with intangible assets and share-based payments.

## Capital Structure

The Group is entirely equity funded, which is appropriate during the current stage of development. As the Group develops, the capital structure will be reassessed on a project-by-project basis.

## Treasury Management

The Group has adopted a low-risk approach to treasury management. Cash balances are invested in fixed interest term deposit accounts with maturity dates to suit projected liquidity requirements. Credit risk is addressed by the Group's treasury policy. Deposits are selected based on achieving the optimum balance of yield, security and liquidity. Foreign exchange risk is primarily mitigated through natural hedging of receipts and payments. See note 3 to the Accounts for further detail of financial risk management.

## Principal Risks and Uncertainties

The principal risks inherent in the operation of the Group are well understood by the Board of Directors and the management team. Control measures have been established to ensure that these, and other risks, are adequately controlled both in terms of frequency and consequence. The internal control environment is described in the Corporate Governance Statement. The principal risks and uncertainties affecting the Group and the steps taken to manage these are:



**Customer acceptance of the Group's technologies**

The Group's success depends on potential customer acceptance of its products and processes. There are significant risks in predicting the size and timing of material revenue. The target customers of the Group's products and processes are often in developing countries which carry additional potential risks. The Group seeks to address these risks by building a track record and proving technology capabilities to future customers and industry players. The Group has increased investment in business development as product development progresses. The Group has formed a number of strategic partnerships to create local presence in target countries, overcome pre-qualification criteria on contract tendering and establish new routes to market. The range of applications for the Group's products provides mitigation against the risk of failure in a specific country or application. The Group continues to invest in research and development (R&D) to mitigate the risk of the emergence of competitor technologies.

**Socio-political risks**

Modern Water operates and is looking to secure further contracts and sales, in a number of countries around the world. This exposes the Group to a range of social and political developments and consequentially to potential changes in the operating, regulatory and legal environment. The Group operates and generates revenue in countries where political, economic and social transition is taking place. Some countries have experienced, or may experience in the future, political instability, changes to the regulatory environment, changes in taxation, expropriation or nationalisation of property, civil strife, strikes, acts of war and insurrections. Any of these conditions occurring could disrupt our operations and revenue. The Group seeks to manage these risks through diversifying the regions in which it operates.

**Scaling up the technology**

The Group's Membrane division and certain monitoring products are not yet well established commercially. They have been developed over recent years and whilst proving the technology is largely complete, there remain significant risks associated with commercialising technology and a portfolio of new products. There are technology and procurement risks in scaling up the products through to large scale commercial deployment. The Group seeks to mitigate these risks through the use of partners with proven manufacturing and fabrication capabilities, rather than developing in-house capabilities, and through the development and operation of pilot plants prior to full commercial deployment.

Additionally, there are risks related to developing the optimum contract, royalty and licensing models to derive value from the products. The Group manages these risks through employment of executives and senior management with significant experience both in the water industry and in the development and growth of early stage companies.

**IP protection**

The Group's ability to generate value from its products depends in part on the development and protection of its IP. The Group assigns significant resources, both internally through the Company's General Counsel and technical staff, and externally through patent attorneys to enhance and protect its patented and non-patented IP.

**Recruitment and retention of key personnel**

The Group's directors and employees are highly qualified and experienced. Recruiting and retaining key staff is critical to the overall success. Knowledge and experience of the Group's products and customer base is retained by a relatively small number of individuals. The risk of staff loss is mitigated through its HR policies, competitive remuneration (including the Modern Water plc Incentive Plan), performance appraisals and training.

**Health and safety**

There are inherent health and safety risks with the deployment of the core membrane and monitoring products. The mitigation of any health and safety events involving the Group's products is key to the strategy for growth. The Group mitigates its health and safety risks through its Group Health and Safety Policy which includes regular reporting to the Board and to the Management Team.

**Capital risks**

It may be desirable for the Company to raise additional capital by way of the further issue of Ordinary Shares to enable the Company to progress through further stages of development. Any additional equity financing may be dilutive to shareholders. There can be no assurance that such funding, if required, will be available to the Company.

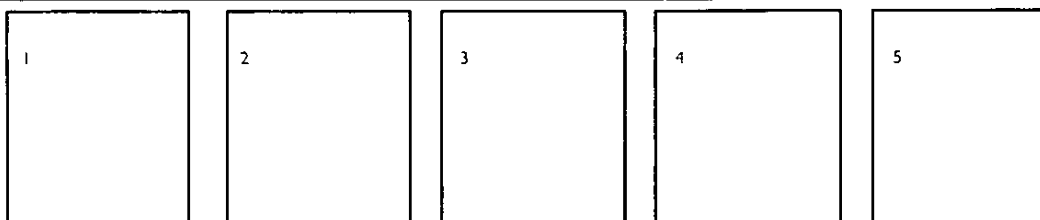
**Financial risks**

These risks and mitigating controls are described in note 3 to the Accounts.

The Strategic Report was approved by the Board of Directors on 11 March 2015 and signed on its behalf by

**Simon Humphrey**  
Chief Executive Officer  
11 March 2015

# The Board of Directors



## 1 Robert Clarke

Interim Non-Executive Chairman  
Robert who qualified as a chartered accountant, has worked in the private equity industry for more than 20 years first at Electra Partners and subsequently as a founding partner of Motion Equity Partners. Since leaving Motion Equity Partners in 2008 he has focussed on using his experience to assist a variety of businesses in their development.

## 2 Simon Humphrey

Chief Executive Officer  
Simon is a co-founder of the Group and has been CEO since Modern Water's inception in December 2006. Simon oversees the day-to-day running of the Group, ensuring the Company and its investments progress successfully. He brings a host of water industry and capital investment experience to the role and oversees the smooth operation of Modern Water's sites internationally.

## 3 Michael Gradon

Senior Independent Non-Executive Director  
Michael has over 25 years' experience in senior commercial management and legal positions. He spent 20 years at P&O and was a main board director for eight years until its takeover in 2006 by Dubai Ports World. His roles included group commercial and legal director, Chairman of P&O's property business and Chief Executive Officer of its largest infrastructure project. He is a Non-executive Director of Exclusive Hotels Grosvenor Limited and AerCap Holdings NV and a member of the committee of the All England Lawn Tennis Club and the Wimbledon Championships.

## 4 Mike Townend

Non-Executive Director  
Mike is the Chief Investment Officer at IP Group plc. He joined the IP Group's board as head of Capital Markets in 2007 from Lehman Brothers where he was Managing Director of European Equities and Head of Equity Sales to Hedge Funds. He has 20 years' experience in equity capital markets and investment process and was also a key member of the senior relationship management programme at Lehman Brothers. Prior to this he was an Executive Director at Donaldson, Lufkin and Jenrette with responsibility primarily for building the bank's business with hedge funds and alternatives. Mike has sourced, co-led or led numerous private and public transactions. He is the IP Group representative on the boards of Modern Water plc, Evocutis plc and Revolymer plc. He is also a Non-executive Director of Green Urban Transport Limited.

## 5 Toby Schumacher

General Counsel and Company Secretary  
Toby has been providing legal advice to international businesses for more than 15 years both in private practice and as in-house counsel and company secretary. Toby is a barrister who trained in London as well as at the European Commission's Legal Service in Brussels and the European Court of Justice in Luxembourg. After practicing EU and competition law at Wragge & Co in Birmingham, Toby joined Severn Trent Plc as in-house counsel. Prior to joining Modern Water, he worked for Veolia Water Solutions & Technologies for almost eight years, first on large international projects, then as its regional General Counsel & Company Secretary, covering various jurisdictions and international businesses within the Group.

# The Management Team

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## 1 Roger Webster

Managing Director

Membrane Processes Division

Roger is responsible for the Membrane Processes business. He leads the Business Development team and is responsible for the deployment, licensing and selling of the Group's technology. In his previous role with Bwater plc and Cascal NV Roger gained extensive international experience in Asia, the Middle East, the Americas and most recently Africa where he was Managing Director of the South African businesses. He has a wide range of management and business development experience within the water utilities sector.

## 2 Neil Townend

Managing Director

Monitoring Division

Neil leads the Monitoring division and is responsible for increasing sales and market penetration for Modern Water's leading water monitoring technologies. He has over 20 years technical and commercial experience in the environmental and water sectors. Neil has previously held technical positions in environmental consultancy with RPS Consulting and SGS Group and senior commercial roles in sales and marketing in Chemviron Carbon, the European operation of Calgon Carbon Corporation.

## 3 Peter Nicoll

Technical Director

Peter leads the multi-disciplined technical team at Modern Water where he has been instrumental in the development, design and successful deployment of Modern Water's FO based technologies. He is the inventor of a number of FO and related processes. A graduate of the University of Glasgow, he is a Chartered Engineer and a Fellow of the Institution of Mechanical Engineers. His previous experience includes Director of Business Development for Fichtner Consulting Engineers Ltd where he was responsible for heading up the business development and sales functions. He has extensive broad expertise in all the major desalination processes having held a number of senior roles both technically and commercially at Weir Westgarth.

## 4 Peter Bristow

Group Financial Controller

Peter leads the finance team for Modern Water. He has a wide range of experience across a number of finance disciplines including M&A, group and divisional finance, internal and external audit roles. He has previously held senior finance roles in organisations undergoing high levels of growth and change including Virgin Media, Telewest Communications and Thames Water. Peter qualified as a Chartered Accountant over 15 years ago with Coopers and Lybrand.

## 5 Alan McQuillin

Senior Vice President,

Operations & Technology

Monitoring Division

Alan joined Modern Water in 2011 as part of the acquisition of the Strategic Diagnostics Inc (SDIX) Water Quality division. Alan has more than 22 years of experience in Life Sciences with SDIX, where he most recently worked as Senior Director of Quality, leading SDIX to ISO 9001:2008 certification. Other expertise includes operations management, new product development and product management. In the new product development group he developed test kits for environmental contaminants such as PCBs, TNT, and PCP lateral flow assays and ELISAs for the detection of GM crops, and research with the Microtox® platform.

# Corporate Governance Statement

## Corporate Governance

The Board of Modern Water plc is committed to integrity business ethics and achieving good standards of corporate governance. As an AIM-listed company, Modern Water plc is not required to issue a statement of compliance with the principles and provisions of 'The UK Corporate Governance Code' (the 'Code'). However, this Corporate Governance Statement, together with the information contained in the Directors' Remuneration Report on pages 12 to 14, explains how the directors seek to apply the requirements of the Code to the Group, where practical given its size, resources and stage of development.

## Board of Directors

The Board comprises one executive director the Chief Executive Officer (Simon Humphrey) and three non-executive directors (Michael Gradon, Mike Townend and Robert Clarke). Robert Clarke was appointed the Interim Non-executive Chairman on 1 January 2015, following the resignation of Neil McDougall as Executive Chairman. Michael Gradon is the senior independent non-executive director and Mike Townend is a representative of IP Group plc.

The business and management of the Group and its subsidiaries are the collective responsibility of the Board. At each meeting the Board considers and reviews the performance of each of the major projects. The Board has a formal written schedule of matters reserved for its review and approval. These include the approval of the annual budget, major capital expenditure, investment proposals, the interim and annual results and a review of the overall system of internal control and risk management.

Authority for the execution of the approved policies, business plan and daily running of the business is delegated to the executive directors. In addition, there is a Management Team whose purpose is to assist the Chief Executive Officer in the performance of his duties.

Modern Water plc's Articles of Association require one third of the directors to stand for re-election each year at the Annual General Meeting. Accordingly, Michael Gradon will retire and offer himself for re-election at the forthcoming Annual General Meeting.

All directors have access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures and applicable rules and regulations are observed. The Board has a procedure whereby any director may seek, through the office of the Company Secretary, independent professional advice, at the Group's expense, in furtherance of his duties.

Formal agendas and reports are provided to the Board on a timely basis for Board and committee meetings and the Chairman ensures that all directors are properly briefed on issues to be discussed at Board meetings. Directors are able to obtain further advice or seek clarity on issues raised at the meetings from within the Group or from external sources.

## Business Ethics

We are committed to acting fairly and ethically in all countries in which we operate. We expect the same standards from all third parties who provide services for Modern Water plc and its subsidiary companies. We maintain anti-bribery, and gifts and entertainment policies and procedures for contractual commitments to better manage risk with third parties.

## Committees

The Board has a Remuneration Committee and an Audit Committee. The executive director is not a member of the committees but attends the meetings by invitation to facilitate business, if appropriate. The Company Secretary acts as secretary to the committees. The Board does not have a Nomination Committee and Board appointments are consequently a matter for the Board as a whole. The Board is satisfied that the committees discharged their responsibilities appropriately.

## Remuneration Committee

The Remuneration Committee consists of Michael Gradon (Chairman), Robert Clarke and Mike Townend. Further details of the committee and its policies are set out in the Directors' Remuneration Report on pages 12 to 14.

## Audit Committee

The Audit Committee consists of Robert Clarke (Chairman), Michael Gradon and Mike Townend.

The committee reviews and makes recommendations on the appointment, reappointment and removal of the external auditors, the review of the scope and results of the external annual audit by the auditors, their cost effectiveness, independence and objectivity. The committee also reviews the nature and extent of any non-audit services provided by the external auditors. No independence issues were noted during the year. The Group Financial Controller monitors the level and nature of non-audit services and specific assignments are identified for approval by the Audit Committee as appropriate.

In addition, the Audit Committee reviews the effectiveness of internal controls, considers the need for an internal audit function and considers any major accounting issues and reports on such matters to the Board. The Audit Committee reviews the integrity of the financial statements and formal announcements.

A whistle-blowing arrangement exists whereby matters can be confidentially reported to the committee.

**Attendance**

The following table shows attendance of the directors at meetings of the Board Remuneration and Audit Committees during the year

	Board		Remuneration		Audit	
	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend
Neil McDougall	7	7	-	-	-	-
Simon Humphrey	7	7	-	-	-	-
Michael Gradon	7	7	2	2	2	3
Mike Townend	7	7	2	2	3	3
Robert Clarke	7	7	2	2	3	3

**Internal Control**

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The implementation and maintenance of the risk management and internal control systems are the responsibility of the executive director(s) and senior management. The internal control system is designed to mitigate the principal risks, amongst others detailed in the Directors Report, but it does not provide absolute assurance that these risks are eliminated or against material misstatement or loss. The Board is satisfied with the controls in place for identification and management of risk and that the reporting lines have been in place throughout the year under review. The key internal controls in place during the year and up to the date of approval of the report included:

- Reporting to the Board including key financial information and commentary (Group Statement of Comprehensive Income, Group Statement of Financial Position, Group Statement of Cash Flows) and the Chief Executive Officers report on the business significant changes and the external marketplace, including the extent to which they represent significant risk
- Detailed corporate policies and procedures document to address key operating and compliance risk areas, including procurement, treasury, human resources, health and safety
- Clear organisational structure with defined reporting lines and delegated authorities
- The Audit Committee
- Centralised accounts team providing financial control and support to all Group companies
- An annual strategy review and an annual budget approved by the Board

The Board has considered the need for an internal audit function, but because of the size and nature of its operations does not consider it necessary at the current time.

**Relations with Shareholders and Investors**

The Board is regularly updated regarding meetings and communications with shareholders. An analysis of the shareholder base is presented to the Board on a quarterly basis. Research notes and broker analysis are circulated to and discussed with the Board. During the year, the Chairman at the time met with institutional investors at meetings arranged by the Group's brokers and financial PR advisers.

Copies of the Annual Report and Accounts are issued to all shareholders. Copies of the Annual Report and Accounts and the Interim Statement are available on the website [www.modernwater.com](http://www.modernwater.com). The Group makes full use of its website to provide information to shareholders and other interested parties. The website provides a facility to receive email alert notifications of Group news and announcements to the London Stock Exchange. Shareholders are given the opportunity to raise questions at the Annual General Meeting and the directors are available both prior to and after the meeting for further discussion with shareholders. Michael Gradon as Senior Independent Non-executive Director is available to shareholders where contact through the normal channels of Chairman, Chief Executive Officer or Company Secretary are inappropriate or have failed to resolve concerns.

# Directors' Remuneration Report

## Introduction

This report has been approved by the Board and the Remuneration Committee (the Committee). It has been prepared to comply with the disclosure requirements of Schedule 5 to the Large and Medium Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The report also provides the information required to be reported on Directors' remuneration under AIM Rule 19. The Committee is committed to maintaining high standards of corporate governance and has taken steps to comply with the principles of best practice, including the ABI Principles of Remuneration and The UK Corporate Governance Code in so far as they can be applied practically given the size of the Group.

## Role of the Remuneration Committee

The Committee determines, in accordance with its terms of reference, the remuneration and other benefits, including bonuses and share-based payments of the executive director.

The Committee consulted with the executive director about its remuneration proposals for the year.

## Remuneration Policy

The Committee is aware that the remuneration package should be sufficiently competitive to attract, retain and motivate individuals capable of achieving the Group's objectives and thereby enhancing shareholder value. Performance-based remuneration should be clearly aligned with business strategy and objectives and be regularly reviewed. Overall arrangements should be prudent, well communicated, incentivise effectively and recognise shareholders' expectations.

## Service Contracts

The Group's policy is for executive directors to have service contracts with provision for termination of no more than 12 months' notice.

Michael Gradon and Robert Clarke have letters of appointment. Appointments can be terminated by the Group or the individual giving one month's notice. The services of Mike Townend are covered in a services agreement with IP Group plc, a significant shareholder in the Company.

The details of the executive and non-executive directors' service contracts during the year are summarised below.

	Date of contract	Notice period (months)
<b>Executive directors</b>		
Neil McDougall*	18 May 2007	12
Simon Humphrey	18 May 2007	12
<b>Non-executive directors</b>		
Michael Gradon	14 March 2007	1
Mike Townend	18 May 2007	1
Robert Clarke	17 June 2010	1

\*Neil McDougall stepped down from the Board on 31 December 2014.

Biographical details of all directors can be found on page 8.

## Directors' Remuneration

Remuneration for executive director(s) comprise basic salary, annual bonus, pension, share-based payments and insurance cover for medical life and income protection. The bonus payable is determined by performance against objectives approved by the Committee, which are set at the beginning of each year.

The Board, within the limits stipulated by the Articles of Association and with recommendation from the executive directors, determines non-executive directors' fees. The remuneration of the non-executive directors is not pensionable and the non-executive directors do not participate in any of the Group's other remuneration schemes.

Remuneration for the directors during the year was as follows

	Basic salary, allowances and fees £000	* Bonus £000	Compensation for loss of office £000	Benefits £000	Year ended 31 December 2014 Total (ex pension) £000	Pension £000	Year ended 31 December 2014 Total (inc pension) £000	Year ended 31 December 2013 Total (ex pension) £000	Pension £000	Year ended 31 December 2013 Total (inc pension) £000
<b>Executive directors</b>										
Neil McDougall**	169	—	167	6	342	17	359	242	19	261
Simon Humphrey	138	—	—	4	142	14	156	143	14	157
<b>Non-executive directors</b>										
Michael Gradon	35	—	—	—	35	—	35	35	—	35
Robert Clarke	20	—	—	—	20	—	20	20	—	20
Mike Townsend***	—	—	—	—	—	—	—	—	—	—
	362	—	167	10	539	31	570	440	33	473

\* Bonuses are disclosed in the year for which the performance relates. There were no bonuses in relation to 2014 annual performance.

\*\* Neil McDougall stepped down from the Board on 31 December 2014. Mr McDougall had a service contract with the Company terminable by the Company on one year's notice. The Company has agreed to pay Mr McDougall as compensation for loss of office an amount approximately equivalent to one year's salary and other benefits. This amount was £167,000 which includes remuneration in relation to a 12 month consultancy contract between Mr McDougall and the Company. The Remuneration Committee exercised its discretion such that the EMI options granted to Neil McDougall in 2013 were not forfeited on his resignation and continue to be exercisable subject to performance criteria being met. Mr McDougall forfeited a further 268,970 conditional share awards on his resignation from the Board.

\*\*\* The services of Mike Townsend are covered through an agreement with IP Group plc; see note 26 to the Accounts.

#### Modern Water plc Incentive Plan ('MWIP')

The MWIP contains provisions relating to the making of awards in the form of options and conditional awards of ordinary shares.

##### a) Options

During the current year no options under the MWIP were granted, vested, exercised or lapsed for Simon Humphrey. There are vested options outstanding over 373,918 shares. However, since vesting, the Company's share price has been lower than the option exercise price and accordingly these options had not been exercised at 31 December 2014. They will lapse if they remain unexercised as at 12 June 2017.

	Grant date	Vesting date	Outstanding at 1 January 2014 number	Outstanding at 31 December 2014 number	Vested and exercisable at 31 December 2014 number	Option price	Charge to income statement in 2014	Charge to income statement in 2013
Simon Humphrey	6/6/07	12/6/10	373,918	373,918	373,918	£1.19	£nil	£nil

##### b) Conditional share awards

During the current year no conditional shares were awarded to Simon Humphrey. In the prior year 38,970 conditional shares were awarded to Simon Humphrey. No awards lapsed or vested during the year. The director's participation in conditional share awards under the MWIP is as follows:

	Award date	Vesting date	Outstanding at 1 January 2014 number	Forfeited during the year number	Awarded during the year number	Outstanding at 31 December 2014 number	Share price at award date	Charge to income statement in 2014	Charge to income statement in 2013
Simon Humphrey	26/3/13	26/3/16	38,970	—	—	38,970	£0.58	£2,078	£1,559
Simon Humphrey	24/4/12	24/4/15	150,000	—	—	150,000	£0.55	£10,500	£10,500

The extent to which awards will vest depends on the Group's share price on the vesting date. For the conditional shares awarded on 26 March 2013 and those awarded on 24 April 2012, if the share price is £1.00 or more, on the vesting date, the award will vest in full and if the share price is £0.70 or below the award does not vest at all. If the share price is between £0.70 and £1.00 the award partially vests, on a straight line basis. Vesting of the conditional shares awarded on 24 April 2012 is also subject to a non-market performance condition.

**c) Enterprise Management Incentives (EMI) Options**

During the current year no options were granted to Simon Humphrey. During the prior year 431,030 options were granted to Simon Humphrey. No awards lapsed, vested or were forfeited during the year. Holdings of EMI options over ordinary shares issued through the MWIP were as follows:

	Grant date	Vesting date	Outstanding at 1 January 2014 number	Granted during year	Outstanding at 31 December 2014 number	Option price	Charge to income statement in 2014	Charge to income statement in 2013
Simon Humphrey	26/3/13	26/3/16	431,030	—	431,030	£nil	£30,038	£22,529

The options may be exercised after three years to the extent that certain market and non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria; if these are not met the options lapse.

Vesting conditions for 196,030 of Simon Humphrey's options awarded on 26 March 2013 are that if the Company's volume weighted average share price is £1.00 or more during the first three months of 2016, the award will vest in full and if the weighted average share price is £0.70 or below the award does not vest at all. If the weighted average share price is between £0.70 and £1.00 the award partially vests, on a straight line basis.

Vesting conditions for 235,000 of Simon Humphrey's options awarded on 26 March 2013 are that if the Company's volume weighted average share price is £0.85 or more during the first three months of 2016 the award will vest in full and if the weighted average share price is £0.58 or below the award does not vest at all. If the weighted average share price is between £0.58 and £0.85 the award partially vests, on a straight line basis. In addition vesting is subject to a non-market performance condition.

Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest.

**Directors' Interests**

Directors' interests are detailed in the Directors' Report.

**Share Price**

The Modern Water plc closing share price was 19.5p on 31 December 2014. The share price high for 2014 was 42.75p and the low was 19.5p.

On behalf of the Board

**Michael Gradon**

Chairman, Remuneration Committee

11 March 2015



# Directors' Report

The directors present their Annual Report together with the audited consolidated financial statements for the year ended 31 December 2014

## Corporate Structure

The Company is incorporated in England and Wales and has subsidiaries principally incorporated in England and Wales, as well as in China, Oman and the USA.

## Review of the Business and Results

A detailed review of the business is set out in the Strategic Report on pages 3 to 7. This includes comments on the financial performance and position of the Group. Information on the Group's internal control environment, including the content of reporting to the Board, is included in the Corporate Governance Statement on pages 10 to 11.

## Future Developments

Future developments and prospects are set out in the Strategic Report.

## Research and Development

Expenditure recorded in the Statement of Comprehensive Income for R&D during the year was £339,000 (2013: £123,000). Activity included further R&D on the Group's forward osmosis and monitoring technologies.

## Dividends

The directors do not recommend the payment of a dividend (2013: £nil).

## Directors' Interests

The directors in office during the year and up to the date of signing the financial statements, are listed below together with their beneficial interests in the share capital of the Company.

	% of issued share capital	Number of ordinary shares of 0.25p
	31 December 2014	31 December 2014
Neil McDougall*	8.00	6,358,000
Simon Humphrey	2.30	1,832,000
Michael Gradon	1.57	1,246,518
Robert Clarke	0.88	700,000
Mike Townsend	0.76	605,000

\*Neil McDougall stepped down from the Board on 31 December 2014.

#### **Directors' and Officers' Liability Insurance**

The Group maintains liability insurance for its directors and officers. The Group has also provided an indemnity for its directors and the secretary which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006. This provision was in place during the year and up to the date of the Annual Report and Accounts.

#### **Corporate Governance**

The Annual Report includes a separate section that describes the Group's approach to applying the principles of best practice associated with corporate governance.

#### **Financial Instruments**

The Group's financial instruments primarily comprise cash and cash equivalents. In addition, various other financial instruments such as trade receivables and trade payables arise directly from its operations. Please refer to note 3 to the Accounts for greater details of the Group's risks and policies regarding financial instruments.

#### **Annual General Meeting**

The Annual General Meeting will be held at the offices of Modern Water plc on 30 April 2015 at 10:00am. The notice convening the Annual General Meeting is set out on pages 48 to 50 of the Annual Report and Accounts.

#### **Independent Auditors**

The auditors PricewaterhouseCoopers LLP have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the Annual General Meeting.

#### **Directors' Statement as to Disclosure of Information to Auditors**

The directors who were members of the Board at the time of approving the Directors' Report are listed on page 8. Having made enquiries of fellow directors, each of these directors confirms that:

- To the best of each director's knowledge and belief, there is no relevant audit information of which the Group's auditors are unaware.
- Each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information.

By order of the Board

#### **Toby Schumacher**

Company Secretary

11 March 2015

# Statement of Directors' Responsibilities

IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Annual Report, the Directors Remuneration 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 the directors have prepared the group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 group and the company and of the profit or loss of the group 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 accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union 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 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 the group and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

Each of the directors whose names and functions are listed in the Corporate Governance section of the Annual Report confirm that, to the best of their knowledge:

- the group financial statements which have been prepared in accordance with IFRSs as adopted by the EU give a true and fair view of the assets, liabilities, financial position and loss of the group; and
- the directors' report contained in the Strategic Report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that it faces.

**Toby Schumacher**

Company Secretary

11 March 2015

# Independent Auditors' Report

TO THE MEMBERS OF MODERN WATER PLC

## Report on the financial statements

### *Our opinion*

In our opinion

- Modern Water plc's Group financial statements and Company financial statements (the financial statements) give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2014 and of the Group's loss and of the Group's and Company's cash flows for the year then ended,
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006

### *What we have audited*

Modern Water plc's financial statements comprise

- the Group and Company Statements of Financial Position as at 31 December 2014,
- the Group Statement of Comprehensive Income for the year then ended,
- the Group and Company Statements of Changes in Equity and Statements of Cash Flows for the year then ended, and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and as regards the Company financial statements as applied in accordance with the provisions of the Companies Act 2006

In applying the financial reporting framework, the directors have made a number of subjective judgements for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events

### **Opinion on other matter prescribed by the Companies Act 2006**

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

### **Other matters on which we are required to report by exception**

#### *Adequacy of accounting records and information and explanations received*

Under the Companies Act 2006 we are required to report to you if, in our opinion

- we have not received all the information and explanations we require for our audit,
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the Company financial statements are not in agreement with the accounting records and returns

We have no exceptions to report arising from this responsibility

**Directors' remuneration**

Under the Companies Act 2006 we are required to report to you if, in our opinion certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

**Responsibilities for the financial statements and the audit*****Our responsibilities and those of the directors***

As explained more fully in the Statement of Directors' Responsibilities set out on page 17, the directors are responsible for the preparation of the Group and Company 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 & Ireland) (ISAs UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

***What an audit of financial statements involves***

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and Company's circumstances and have been consistently applied and adequately disclosed,
- the reasonableness of significant accounting estimates made by the directors, and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements and evaluating the disclosures in the financial statements.

We test and examine information using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies, we consider the implications for our report.

**Stephen Wootten (Senior Statutory Auditor)**  
**for and on behalf of PricewaterhouseCoopers LLP**

Chartered Accountants and Statutory Auditors

Gatwick

11 March 2015

# Group Statement of Comprehensive Income

Year ended 31 December 2014

	Note	2014 Pre- exceptional £000	Exceptional £000	Total £000	2013 £000
Revenue	5	2,772	—	2,772	3 528
Cost of sales	5	(1,596)	—	(1,596)	(1 805)
Gross profit	5	1,176	—	1,176	1 723
Administrative expenses	8	(5,650)	(190)	(5,840)	(5,847)
Other gains - net	7	—	—	—	146
Goodwill and intangibles impairment	16	—	(12,590)	(12,590)	—
Operating loss before interest, tax, depreciation and amortisation		(4,474)	(12,780)	(17,254)	(3,978)
Depreciation and amortisation	8	(641)	—	(641)	(895)
Operating loss		(5,115)	(12,780)	(17,895)	(4,873)
Finance income	12	178	—	178	129
Finance costs	12	—	—	—	(22)
Loss on ordinary activities before taxation		(4,937)	(12,780)	(17,717)	(4 766)
Taxation	13.1	36	—	36	66
Loss for the year		(4,901)	(12,780)	(17,681)	(4 700)
Other comprehensive income					
Items may be subsequently reclassified to profit or loss					
Foreign currency translation differences on foreign operations		(66)	—	(66)	16
Total comprehensive loss for the year		(4,967)	(12,780)	(17,747)	(4 684)
Loss attributable to					
Owners of the parent		(4,901)	(12,780)	(17,681)	(4 700)
		(4,901)	(12,780)	(17,681)	(4 700)
Total comprehensive loss attributable to					
Owners of the parent		(4,967)	(12,780)	(17,747)	(4 684)
		(4,967)	(12,780)	(17,747)	(4 684)
Loss per share for the year (attributable to owners of the parent)					
Basic loss per share	14.1	6.17p	16.07p	22.24p	6.18p
Diluted loss per share	14.2	6.17p	16.07p	22.24p	6.18p

Modern Water plc has taken advantage of the exemption provided under Section 408 of the Companies Act 2006 not to disclose the parent company statement of comprehensive income

The notes on pages 24 to 47 are an integral part of these consolidated financial statements


# Group and Company Statements of Financial Position

As at 31 December 2014

	Note	Group		Company	
		2014 £000	2013 £000	2014 £000	2013 £000
<b>Assets</b>					
<b>Non-current assets</b>					
Property, plant and equipment	15	444	595	—	—
Intangible assets	16	3,892	16,892	—	—
Investments	17	—	—	2,697	15,918
		4,336	17,487	2,697	15,918
<b>Current assets</b>					
Inventories	18	1,456	1,041	—	—
Trade and other receivables	19	1,654	1,634	6,319	6,870
Cash and cash equivalents	20	6,801	11,432	5,666	10,247
		9,911	14,107	11,985	17,117
<b>Total assets</b>		<b>14,247</b>	<b>31,594</b>	<b>14,682</b>	<b>33,035</b>
<b>Equity and liabilities</b>					
<b>Equity</b>					
Ordinary shares	24	199	199	199	199
Share premium account	24	40,032	40,032	40,032	40,032
Merger reserve		398	13,180	398	13,180
Accumulated losses		(27,958)	(23,181)	(26,188)	(20,542)
		12,671	30,230	14,441	32,869
Non-controlling interests		126	126	—	—
<b>Total equity</b>		<b>12,797</b>	<b>30,356</b>	<b>14,441</b>	<b>32,869</b>
<b>Liabilities</b>					
<b>Non-current liabilities</b>					
Deferred tax liabilities	133	198	234	—	—
<b>Current liabilities</b>					
Trade and other payables	21	1,252	1,004	241	166
		1,252	1,004	241	166
<b>Total liabilities</b>		<b>1,450</b>	<b>1,238</b>	<b>241</b>	<b>166</b>
<b>Total equity and liabilities</b>		<b>14,247</b>	<b>31,594</b>	<b>14,682</b>	<b>33,035</b>

The notes on pages 24 to 47 are an integral part of these consolidated financial statements

The financial statements on pages 20 to 47 were approved by the Board of directors on 11 March 2015 and signed on its behalf by

  
**Simon Humphrey**  
 Chief Executive Officer  
 11 March 2015

# Group and Company Statements of Changes in Equity

Year ended 31 December 2014

Group	Note	Ordinary shares £000	Share premium Account £000	Merger reserve £000	(Accumulated losses)/ Retained earnings £000	Total £000	Non- controlling interest £000	Total Equity £000
Balance as at 1 January 2013		149	30,532	13,180	(18,660)	25,201	126	25,327
Comprehensive loss								
Loss for the year		—	—	—	(4,700)	(4,700)	—	(4,700)
Foreign currency translation differences		—	—	—	16	16	—	16
Total comprehensive loss		—	—	—	(4,684)	(4,684)	—	(4,684)
Transactions with owners								
Issue of shares	24	50	9,500	—	—	9,550	—	9,550
Share-based payments	10	—	—	—	163	163	—	163
Total transactions with owners		50	9,500	—	163	9,713	—	9,713
Balance as at 1 January 2014		199	40,032	13,180	(23,181)	30,230	126	30,356
Comprehensive loss								
Loss for the year		—	—	—	(17,681)	(17,681)	—	(17,681)
Impairment transfer		—	—	(12,782)	12,782	—	—	—
Foreign currency translation differences		—	—	—	(66)	(66)	—	(66)
Total comprehensive loss		—	—	(12,782)	(4,965)	(17,747)	—	(17,747)
Transactions with owners								
Share-based payments	10	—	—	—	188	188	—	188
Total transactions with owners		—	—	—	188	188	—	188
Balance as at 31 December 2014		199	40,032	398	(27,958)	12,671	126	12,797
<b>Company</b>								
Balance as at 1 January 2013		149	30,532	13,180	(15,256)	28,605	—	28,605
Comprehensive loss								
Loss and total comprehensive loss for year		—	—	—	(5,449)	(5,449)	—	(5,449)
Total comprehensive loss		—	—	—	(5,449)	(5,449)	—	(5,449)
Transactions with owners								
Issue of shares	24	50	9,500	—	—	9,550	—	9,550
Share-based payments	10	—	—	—	163	163	—	163
Total transactions with owners		50	9,500	—	163	9,713	—	9,713
Balance as at 1 January 2014		199	40,032	13,180	(20,542)	32,869	—	32,869
Comprehensive loss								
Loss and total comprehensive loss for year		—	—	—	(18,616)	(18,616)	—	(18,616)
Impairment transfer		—	—	(12,782)	12,782	—	—	—
Total comprehensive loss		—	—	(12,782)	(5,834)	(18,616)	—	(18,616)
Transactions with owners								
Share-based payments	10	—	—	—	188	188	—	188
Total transactions with owners		—	—	—	188	188	—	188
Balance as at 31 December 2014		199	40,032	398	(26,188)	14,441	—	14,441

The notes on pages 24 to 47 are an integral part of these consolidated financial statements. The merger reserve resulted from the acquisitions of Surrey Aquatechnology Limited on 12 June 2007 and Cogent Environmental Limited on 2 February 2011 and represents the fair value of equity-based consideration. During the year the goodwill, intangible and investment assets resulting from the acquisition of Surrey Aquatechnology Limited were impaired, as a result there has been a transfer between the corresponding balance in the Merger Reserve and Accumulated Losses. The Merger Reserve balance as at 31 December 2014 relates solely to the acquisition of Cogent Environmental Limited.



# Group and Company Statements of Cash Flows

Year ended 31 December 2014

	Note	Group		Company	
		2014 £000	2013 £000	2014 £000	2013 £000
<b>Cash flows from operating activities</b>					
Cash used in operations	25	(4,516)	(3,723)	(4,634)	(4,532)
<b>Net cash flows used in operating activities</b>		<b>(4,516)</b>	<b>(3,723)</b>	<b>(4,634)</b>	<b>(4,532)</b>
<b>Cash flows from investing activities</b>					
Purchase of property, plant and equipment	15	(96)	(144)	—	—
Proceeds from sale of property plant and equipment		—	10	—	—
Purchase of patents and development costs	16	(76)	(81)	—	—
Interest received		50	93	50	77
<b>Net cash flows (used in)/generated from investing activities</b>		<b>(122)</b>	<b>(122)</b>	<b>50</b>	<b>77</b>
<b>Cash flows from financing activities</b>					
Proceeds from issuance of ordinary shares		—	9,550	—	9,550
<b>Net cash flows generated from financing activities</b>		<b>—</b>	<b>9,550</b>	<b>—</b>	<b>9,550</b>
Net (decrease)/increase in cash and cash equivalents		<b>(4,638)</b>	5,705	<b>(4,584)</b>	5,095
Cash and cash equivalents at the beginning of the year	20	11,432	5,751	10,247	5,139
Exchange gains/(losses) on bank balances		7	(24)	3	13
<b>Cash and cash equivalents at the end of the year</b>	<b>20</b>	<b>6,801</b>	<b>11,432</b>	<b>5,666</b>	<b>10,247</b>

The notes on pages 24 to 47 are an integral part of these consolidated financial statements

# Notes to the Consolidated Financial Statements

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## 1. General Information

Modern Water plc is a public limited company incorporated and domiciled in England and Wales whose shares are publicly traded on the Alternative Investment Market (AIM), a market operated by the London Stock Exchange. The registered office and principal place of business is Bramley House, The Guildway Old Portsmouth Road Guildford, Surrey GU3 1LR.

The consolidated and Company financial statements of Modern Water plc (the Company) and its subsidiaries (together the Group) for the year ended 31 December 2014 were authorised for issue by the Board of directors on 11 March 2015 and the statement of financial position was signed by the Chief Executive Officer (Simon Humphrey).

The principal accounting policies adopted by the Group and Company are set out below.

## 2. Summary of significant accounting policies

The principal accounting policies have been applied consistently throughout the current and prior year unless otherwise stated, in the preparation of these financial statements.

### 2.1 Basis of preparation and changes in accounting policy and disclosures

The financial statements of Modern Water plc have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU IFRS Interpretations Committee (IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Under Section 479A of the Companies Act 2006, exemptions from an audit of the accounts for the financial year ended 31 December 2014 have been taken by Aguacure Ltd (05893786), Cymtox Limited (05025552), Modern Water Monitoring Limited (06701882), MW Monitoring Limited (07495046), MW Monitoring IP Limited (07810737), Modern Water Holdings Limited (07588452) and Surrey Aquatechnology Limited (05698169). As required, the Company guarantees all outstanding liabilities to which the subsidiary companies listed above are subject at the end of the financial year until they are satisfied in full and the guarantee is enforceable against the parent undertaking by any person to whom the subsidiary companies listed above is liable in respect of those liabilities.

### 2.1.1 Going concern

The directors are required by company law to be satisfied that the Group has adequate resources to continue in business for the foreseeable future. A review has been conducted and the directors have concluded that such resources are available, and that the going concern basis is justified in the preparation of the financial statements.

### 2.1.2 Changes in accounting policy and disclosures

#### a) New and amended standards adopted by the Group

The following standards have been adopted by the group for the first time for the financial year beginning on or after 1 January 2014 and have a material impact on the group.

- Amendments to IAS 36 'Impairment of assets' on the recoverable amount disclosures for non-financial assets. This amendment removed certain disclosures of the recoverable amount of CGUs which had been included in IAS 36 by the issue of IFRS 13.

Other standards, amendments and interpretations which are effective for the financial year beginning on 1 January 2014 are not material to the group.

#### b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2014 and not adopted early

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2014 and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

### 2.1.3 Parent company financial statements

Modern Water plc has taken advantage of the exemption provided under section 408 of the Companies Act 2006 not to disclose the parent company statement of comprehensive income. The loss attributed to the parent company in the year was £18,616,000 (2013 loss of £5,449,000).

### 2.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries).

#### a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the company controls an entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. Identifiable intangible assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets.

Acquisition costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is re-measured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the group is recognised at fair value at the acquisition date.

Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39, either in the income statement or as a change to other comprehensive income.

Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred in relation to the fair value of the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in the income statement.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

#### b) Joint ventures

Joint ventures are entities over which the company exercises joint control with other parties under a formal arrangement.

Investments in joint ventures are accounted for using the equity method of accounting. The cost of investment in joint ventures is measured at the fair value of the assets given and liabilities incurred or assumed at the date of exchange. The Company's investment includes goodwill identified on acquisition, net of any accumulated impairment losses.

The Group's share of its joint ventures' post-acquisition profits or losses is recognised in the statement of comprehensive income and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in a joint venture equals or exceeds its interest in the joint venture, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint venture.

# Notes to the Consolidated Financial Statements *continued*

Unrealised gains on transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the joint venture. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of joint ventures are changed where necessary to ensure consistency with the policies adopted by the Group.

## **c) Transactions with non-controlling interests**

The Group treats transactions with non-controlling interests as transactions with the equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of the net assets of the subsidiary is recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is re-measured to fair value with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the income statement.

## **2.3 Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Board that makes strategic decisions.

## **2.4 Foreign currency translation**

### **a) Functional and presentation currency**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling (£) which is the Group's presentation currency and the Company's functional currency.

### **b) Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within 'finance income or cost'.

### **c) Group companies**

The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates in which case income and expenses are translated at the rate on the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income.

## **2.5 Property, plant and equipment**

All property, plant and equipment is shown at cost less accumulated depreciation and impairment. Cost includes expenditure that is attributable to the acquisition of the items. Depreciation on assets is calculated using the straight-line method to allocate the cost of each asset to its residual value over its estimated useful economic life as follows:

Leasehold improvements	–	remaining term of the lease
Plant and machinery	–	three to five years
Motor vehicles	–	three to five years
Office equipment	–	three to five years
Furniture, fixtures and fittings	–	three to five years

The assets' residual values and useful economic lives are reviewed and adjusted if appropriate, at each balance sheet date

Subsequent costs are capitalised only when it is probable that they will result in future economic benefits flowing to the Group and when they can be measured reliably. All other repairs and maintenance expenditure is charged to the income statement in the period in which it is incurred.

## 2.6 Intangible assets

### a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/joint venture/associate at the date of acquisition.

- goodwill on acquisitions of subsidiaries is included in 'intangible assets' and
- goodwill on acquisitions of joint ventures is included in 'investments in joint ventures' and is tested for impairment as part of the overall balance.

Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Goodwill is not subject to amortisation but is tested for impairment annually to identify whether there have been events or a change in circumstances to indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows in Cash Generating Units (CGUs). The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose. Due to the pre-revenue stage of most of the Group's technologies, value in use has been assessed based on the present value of applying the Group's technologies to potential contracts in the future and an assessment of the expected number of such contracts.

### b) Patents and trademarks

Separately acquired patents are recognised at the historical cost. They have a finite useful economic life and are subsequently carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents over their estimated useful economic lives of 20 years from patent filing.

Trademarks are initially recorded at historical cost. They have a finite useful life and are subsequently carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks over their useful economic life of five years from filing.

### c) Research and development

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Any internally-generated development costs are recognised as an asset only if all of the following are met:

- an asset is created that can be identified
- it is probable that the asset created will generate future economic benefits and
- the development cost of the asset can be measured reliably

Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Internally generated intangible assets are amortised on a straight-line basis over three years.

Development costs identified as a result of a business combination are accounted for in accordance with IAS 38, brought on to the consolidated statement of financial position at the date of acquisition and amortised on a straight-line basis between 10 and 20 years.

Patented technology acquired as part of a business combination is recorded at the fair value on acquisition and amortised on a straight-line basis over the useful economic life of the asset.

# Notes to the Consolidated Financial Statements *continued*

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## **2.7 Impairment of intangible assets, investments, property, plant and equipment**

Goodwill has an indefinite useful economic life, is not subject to amortisation and is tested annually for impairment as described in notes 2.6 and 1.6

Assets that are subject to amortisation or depreciation are tested for impairment when events or a change in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows (CGUs). Due to the pre-revenue stage of most of the Group's technologies, value in use has been assessed based on the present value of applying the Group's technologies to potential contracts in the future and an assessment of the expected number of such contracts.

## **2.8 Investments**

Investments are stated at cost less any provision for impairment. Investment assets are tested annually for impairment, see note 1.7

## **2.9 Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

## **2.10 Financial instruments**

Financial assets and liabilities are recognised in the Group's statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

### **a) Cash and cash equivalents**

Cash at bank comprises cash available on demand. Short-term deposits with a maturity from inception of one year or less placed with financial institutions are classified as cash equivalents if they can be converted to cash at any time without significant penalties.

### **b) Trade receivables**

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Specific bad and doubtful debt provisions are established against trade receivables that are greater than six months overdue where management considers that there is a risk that the customer will not settle the receivable balance.

### **c) Trade payables**

Trade payables are not interest bearing and are initially measured at their fair value and subsequently measured at amortised cost.

## **2.11 Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour and other direct costs but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business less applicable variable selling expenses. Provisions, if necessary, are made for slow-moving, obsolete and defective inventories.

## **2.12 Share Capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction net of tax, from the proceeds.

## 2.13 Employee benefits

### a) Pension obligations

The Group has a defined contribution pension plan for directors and staff. The scheme is administered by an insurance company to which the Group pays fixed contributions and the Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

### b) Share-based payments

Share-based incentive arrangements are provided to directors and employees. The Group operates a number of share-based payment schemes under the Modern Water plc Incentive Plan (MWIP) which is described in note 10.

The fair value of the services received in exchange for the share-based payment is recognised as an expense with a corresponding credit to equity, where the payment is equity-settled. If cash settled then the cost is accrued in the balance sheet. Where equity-settled the total amount to be expensed over the vesting period is determined by reference to the fair value of the options and bonus shares granted at the date of grant using either a Black-Scholes or Monte Carlo pricing model. Where cash-settled the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted at the date of grant and then reassessed at each subsequent reporting date using the Black-Scholes model. The annual charge is modified to take account of awards granted to employees who leave the Group during the performance or vesting period and forfeit their rights to the share options and in the case of non-market related performance conditions, where it becomes unlikely they will vest.

The grant by the Company of share-based payments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services received measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity.

## 2.14 Taxation

The current income tax charge is calculated on the basis of the tax laws applicable to the current year and enacted or substantively enacted at the balance sheet date in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination which at the time of the transaction affects neither the accounting nor the taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

## 2.15 Revenue and income recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods, services and royalty income in the ordinary course of the Group's activities. Revenue is shown net of trade and early settlement discounts, value added tax (VAT) and similar sales taxes.

### a) Royalties

Royalty income is recognised as revenue on an accruals basis in accordance with the substance of the relevant agreements. Royalty income is therefore recognised in the year on the basis of royalty statements provided by distributors.

# Notes to the Consolidated Financial Statements *continued*

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## **b) Provision of goods and services**

Revenue from the provision of goods and services is recognised when the risks and rewards of ownership have been transferred to the customer. The risks and rewards of ownership are deemed to have been transferred when the goods are delivered and the services provided to the customer. Where the customer wishes to delay taking delivery of the goods, agrees to be invoiced for the goods and the goods are on hand ready for delivery and usual payment terms apply, transfer of the risks and rewards is deemed to occur when the goods are ready to be shipped to the customer. Goods in transit are deemed to be owned by the customer if the customer arranges transit or by the Group if the Group arranges transit. Revenue for services revenue is generally for the installation and servicing of products and the training of customer staff. Revenue for services is recognised once the service has been completed.

## **c) Interest**

Income is recognised as interest accrues using the effective interest method. Interest income is included in finance income in the statement of comprehensive income.

## **d) Grants**

Grants are recognised when there is reasonable assurance that the entity will comply with the conditions related to them and that the grants will be received.

Grants related to income are recognised over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. Grants relating to income are recognised as other income in the statement of comprehensive income. Unutilised grants are held in accruals and deferred income in the Group Statement of Financial Position.

Grants relating to assets are deducted from the carrying value of the asset. The statement of comprehensive income is affected by a reduced depreciation charge over the useful economic life of the asset.

## **2.16 Exceptional items**

Exceptional items are disclosed separately in the financial statements where it is necessary to do so to provide further understanding of the financial performance of the group. They are material items of income or expense that have been shown separately due to the significance of their nature or amount.

## **3. Financial risk management**

The Group is subject to a number of financial risks, principally market risk (interest rate risk and foreign exchange risk), credit risk, liquidity risk, and capital risk. The Group's policy aims to mitigate these risks through a conservative approach to treasury management.

### **a) Market risk**

#### **(i) Interest risk**

The Group's interest rate risk arises from variable interest rates on finance income and investing cash flows from the cash deposits. The Group's policy is to invest in fixed interest term deposits, thereby mitigating uncertainty over the future interest receipts. As the Group has no borrowings, it only has limited interest rate risk.

#### **(ii) Foreign exchange risk**

During 2014, the majority of the Group's costs were in pounds sterling and US dollars; therefore, it was appropriate to hold funds in pounds sterling and US dollars. The Group does have a major supplier who invoices in Australian dollars, and for these payments, the Group maintains an Australian dollar bank account, purchasing Australian dollars when a commitment is certain or when there is a favourable exchange rate. In addition to sterling and US dollar accounts, the Group does maintain Australian dollar and Euro accounts for customer receipts and to hold currency to hedge against future commitments in those currencies.



**b) Credit risk**

The Group is exposed to credit risk from placing significant deposits with counterparties. The Group's policy is to restrict counterparties to institutions that are Moody's A rated when the deposit is placed, ratings can change during the term of the deposit. Cash balances by counterparty credit rating are listed in note 20. Additionally the Group is exposed to credit risk from customers. This risk is mitigated in the Monitoring Division through new customers being required to pay in advance for their first purchase. Customers seeking credit undergo a credit application process and are subject to credit limits. Accounts receivable balances are monitored and actively managed on a regular basis.

**c) Liquidity risk**

The Group's liquidity risk arises from cash being on deposit with counterparties and therefore not available at short notice to meet requirements. The Group's policy is to maintain rolling cash flow forecasts and place cash on deposit with a range of maturity dates to meet forecast liquidity requirements. The maximum duration for a term deposit is 12 months from the date of deposit.

**d) Capital risk**

Capital risk relates to the long term funding requirements for the Group. The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. At the Group's current stage of development it is appropriate for it to be wholly funded by equity. As the Group develops, this capital structure will be reviewed.

**4. Critical accounting estimates and judgements**

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will by definition seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are addressed below:

**a) Estimated impairment of goodwill**

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 2.6. The recoverable amounts of cash generating units (CGU) have been determined based on the higher of fair value less costs of disposal and value-in-use calculations. These calculations require the use of estimates. An impairment charge of £11,902,000 was made to goodwill in 2014. Detail of the impairment tests and the key assumptions is included in note 16.

**b) Acquired intangible assets**

The Group is carrying significant intangible assets (patented technology and research and development) arising from business combinations in prior years, in accordance with the accounting policy stated in note 2.6. Estimation of the fair values of intangible assets acquired through business combinations requires assumptions as to replacement cost, value, future useful economic life and future cash flows for impairment tests. There is a high degree of judgement required in making these assumptions which impact both the initial fair value acquired and the carrying value as at the balance sheet date.

**c) Share-based payments**

The fair value calculation of share-based payments requires several assumptions and estimates. Their details are included in note 10. Such assumptions and estimates could change and could affect the amount recorded.

**5. Segmental analysis****5.1 Reportable segments**

The chief operating decision-maker is deemed to be the Board for whom monthly financial information is provided by division to gross profit and direct overheads below this financial information is reported in a consolidated Group format. For management reporting purposes the Group is organised into two operating segments (i) membranes and (ii) monitoring, which matches this divisional split.

Administrative expenses which are directly attributable to the two main operating divisions (comprised of business development, sales operations and technical expenditure) are reported as expenditure in the respective division. However a significant proportion of the Group's expenditure (legal, marketing, finance, facilities and directors' expenditure) is managed and reported centrally. As the commercial activities of the Group develop this financial information is expected to evolve.

# Notes to the Consolidated Financial Statements *continued*

## 5. Segmental analysis (continued)

	2014				2013			
	Membrane £000	Monitoring £000	Central £000	Total £000	Membrane £000	Monitoring £000	Central £000	Total £000
Revenue	57	2,715	—	2,772	36	3,492	—	3,528
Cost of sales	(51)	(1,545)	—	(1,596)	(8)	(1,797)	—	(1,805)
Gross profit/(loss)	6	1,170	—	1,176	28	1,695	—	1,723
Administrative expenses	(1,603)	(2,031)	(2,028)	(5,662)	(1,629)	(1,891)	(2,154)	(5,674)
Share-based payments	—	—	(178)	(178)	—	—	(173)	(173)
Other gains - net	—	—	—	—	—	59	87	146
Goodwill and intangibles impairment	(12,590)	—	—	(12,590)	—	—	—	—
Operating loss before interest, tax, depreciation and amortisation	(14,187)	(861)	(2,206)	(17,254)	(1,601)	(137)	(2,240)	(3,978)
Depreciation and amortisation	—	—	(641)	(641)	—	—	(895)	(895)
Operating loss	(14,187)	(861)	(2,847)	(17,895)	(1,601)	(137)	(3,135)	(4,873)
Finance income	—	—	178	178	—	—	129	129
Finance costs	—	—	—	—	—	—	(22)	(22)
Loss before taxation	(14,187)	(861)	(2,669)	(17,717)	(1,601)	(137)	(3,028)	(4,766)
Taxation	—	—	36	36	—	—	66	66
Loss for the year	(14,187)	(861)	(2,633)	(17,681)	(1,601)	(137)	(2,962)	(4,700)

The Monitoring division recognised £nil (2013 £106,000) revenue from royalties and £2,715,000 (2013 £3,386,000) from sale of goods and services. The Membrane division recognised £nil (2013 £nil) from the sale of desalination equipment and £57,000 (2013 £36,000) from the sale of water and operating and maintenance contracts.

### 5.2 Geographical information

The Group operates in four main geographical regions based on customer location.

	2014			2013		
	Membranes £000	Monitoring £000	Total £000	Membranes £000	Monitoring £000	Total £000
Revenue						
Americas	—	1,187	1,187	—	1,449	1,449
Europe	—	686	686	—	708	708
Middle East and Africa	57	76	133	36	71	107
Asia Pacific	—	766	766	—	1,264	1,264
Total	57	2,715	2,772	36	3,492	3,528

The Group has non-current assets in four countries (2013 four) based on location of the assets.

	2014			2013		
	Property, plant and equipment £000	Intangible assets including goodwill £000	Total £000	Property, plant and equipment £000	Intangible assets including goodwill £000	Total £000
UK	135	3,892	4,027	212	16,892	17,104
US	294	—	294	342	—	342
Oman	—	—	—	13	—	13
Gibraltar	15	—	15	28	—	28
Total	444	3,892	4,336	595	16,892	17,487

Assets and liabilities are presented to the chief operating decision maker in a consolidated Group format. Assets and liabilities are not presented by segment.

### 5.3 Major customers

Within the Monitoring division revenue to one customer totalled £512,000 (2013 £821,000) representing 19% (2013 24%) of the division's revenue. No other customer represented more than 10% of the division's revenue. All revenue in the Membrane division came from a single customer (2013 100%).

### 6. Business combinations

There were no business combinations during the current or prior year.

### 7. Other gains - net

	2014 £000	2013 £000
Grant income	—	87
Other income	—	59
Total	—	146

The grant income relates to work performed on European Union (EU) funded electro-coagulation projects.

### 8. Administrative expenses by nature

	Note	2014 £000	2013 £000
Employee benefits expense	9	2,859	2,658
Share-based payments	10	178	173
Operating lease payments	23.1	441	384
Research and development		339	123
Auditors' remuneration	11	110	112
Loss on disposal of property, plant, equipment and intangible assets		109	40
Other administrative expenses		1,614	2,357
Total administrative expenses before depreciation, amortisation and exceptional charges		5,650	5,847
Exceptional employee benefits expense		190	—
Total administrative expenditure		5,840	5,847
Depreciation and amortisation charges	15,16	641	895
Goodwill and intangibles impairment		12,590	—
Total administrative expenses including depreciation, amortisation and exceptional charges		19,071	6,742

The exceptional employee benefits expense has been described in note 9.

### 9. Employee benefits expense

	Note	2014		2013	
		Group £000	Company £000	Group £000	Company £000
Staff costs for the year including executive directors amounted to:					
Wages and salaries		2,347	362	2,157	501
Social security costs		237	52	238	55
Other pension costs		117	31	120	33
Other benefits and staff costs		158	11	143	13
Total employee benefits expense pre-exceptional charges		2,859	456	2,658	602
Compensation for loss of office recorded as exceptional		190	175	—	—
Total employee benefits expense		3,049	631	2,658	602
Equity-settled share-based payments	10	188	65	163	70
Cash-settled share-based payments	10	(10)	—	10	—
		3,227	696	2,831	672

Other benefits include recruitment fees, private health insurance, life insurance and income protection. Compensation for loss of office has been recorded as an exceptional item given its significance.

# Notes to the Consolidated Financial Statements *continued*

## 9. Employee benefits expense (continued)

	2014		2013	
	Group Number FTE	Company Number FTE	Group Number FTE	Company Number FTE
Monthly average number of employees by activity				
Executive directors	2	2	2	2
Technical	26	—	28	—
Business development	16	—	16	—
Finance, legal and administration	8	—	8	—
<b>Total</b>	<b>52</b>	<b>2</b>	<b>54</b>	<b>2</b>

Key management personnel are considered to be the executive directors

The aggregate amount of emoluments, excluding employers pension contributions, paid to executive directors in respect of qualifying services was £484,000 (2013 £385,000). The highest paid director received £342,000 (2013 £242,000) excluding pension contributions but including in the current year £167,000 for compensation for loss of office. Compensation for loss of office is reported as an exceptional item of expenditure. There were no gains made by directors on the exercise of share options (2013 £nil). No money was received by directors under long term incentive schemes (2013 £nil). The two executive directors in total received £nil in cash bonuses relating to 2014 performance (2013 £45,000). The highest paid director received no cash bonus relating to 2014 performance (2013 £45,000). The Group paid £31,000 (2013 £33,000) to the two executive directors in respect of money purchase pension schemes with the highest paid director receiving £17,000 (2013 £19,000). Total remuneration for non-executive directors was £55,000 (2013 £55,000). See the remuneration table on page 13 of Directors Remuneration Report for further details.

In addition to the above costs for permanent staff, the Group utilises the services of contract and agency staff as circumstances require.

## 10. Share-based payment plans

	2014		2013	
	Group £000	Company £000	Group £000	Company £000
Options (including EMI)	136	63	146	47
Conditional share awards	52	2	17	23
Equity-settled share-based payments	188	65	163	70
Cash-settled share-based payments	(10)	—	10	—
<b>Total share-based payments charged to the income statement</b>	<b>178</b>	<b>65</b>	<b>173</b>	<b>70</b>
Equity-settled share-based payments	188	65	163	70
Capital contribution relating to share-based payments	—	123	—	93
<b>Total share-based payments changes in equity</b>	<b>188</b>	<b>188</b>	<b>163</b>	<b>163</b>

The share-based payment plans are described below. The number of shares issued under these plans is limited to 10% of the issued ordinary share capital of the company.

The Group incurred a £178,000 (2013 £173,000) share-based payment charge of which £65,000 (2013 £70,000) was recognised in the Company's Statement of Comprehensive Income for its employees and a further £123,000 (2013 £103,000) to the employees of subsidiary undertakings. The charge for equity-settled share-based to the employees of the Company's subsidiaries payments of £123,000 (2013 £93,000) is recognised as a capital contribution in the Company balance sheet (note 17). An accrual of £10,000 was recognised in the balance sheet of the prior year for cash-settled share-based payments, but was reversed in 2014 following a year end review of the non-market performance criteria.

### Modern Water plc Incentive Plan (MWIP)

The MWIP was adopted on 1 June 2007 and contains provisions relating to the making of awards in the form of options and conditional awards of ordinary shares (to be received once performance conditions are satisfied).

*a) Options*

Under this scheme share options are granted to management. The exercise price is equal to the market price on the date of the grant. The options may be exercised if certain TSR performance criteria are met. If the performance criteria are not met the options lapse.

The total number of options outstanding at the end of the year was 1,815,877 (2013: 560,877) with a weighted average exercise price of 58p (2013: 119p). Options over 830,000 shares were granted on 23 April 2014 and will vest on 23 April 2017, subject to performance criteria being met. These options will lapse if unexercised by 23 April 2024. Options over a further 505,000 were granted on 10 June 2014 and will vest on 10 June 2017, subject to performance criteria being met. These options will lapse if unexercised by 10 June 2024. Options over 560,877 shares had vested in prior years and were exercisable, but at an exercise price above the current market price. These options will lapse if unexercised by 12 June 2017. Options over 80,000 shares were forfeited during the year. No options lapsed during the year. The movement in the number of share options is set out below.

	2014	2013
At 1 January	560,877	560,877
Granted during year	1,335,000	—
Lapsed	—	—
Forfeited	(80,000)	—
At 31 December	1,815,877	560,877

The fair value of the equity-settled share options granted is estimated as at the date of grant using a Black-Scholes model, taking into account the terms and conditions upon which the options were granted.

Grant date	10 June 2014	23 April 2014
Share price at date of award	34.0p	29.0p
Number of shares options granted	505,000	830,000
Exercise price	34.0p	29.0p
Assumed volatility at date of award (median of historical 50 day moving average)	29%	29%
Vesting period (years)	3.0	3.0
Expected dividend yield	0%	0%
Risk-free discount rate	1.0%	2.0%
Fair value per share awarded	12p	10p

The weighted average remaining contractual life for the share options outstanding at 31 December 2014 is seven years and three months (2013: three years and five months). The weighted average exercise price for options outstanding at the end of the year was 58p (2013: 119p). 560,877 options were exercisable as at 31 December 2014 (2013: 560,877).

*b) Conditional share awards*

The conditional share awards are provisional awards of ordinary shares in Modern Water plc, which vest three years after the date of the award to the extent that performance conditions have been met. The extent to which the award will vest depends on the Group's share price on the vesting date. 350,000 shares conditionally awarded in 2011 lapsed due to the vesting criteria not being met, a further 568,970 were forfeited due to employees leaving the Group. The movement in the number of conditional shares awarded is set out below.

	2014	2013
At 1 January	*1,707,940	2,250,000
Conditionally awarded during year	—	307,940
Lapsed	(350,000)	(450,000)
Forfeited	(568,970)	(400,000)
At 31 December	788,970	*1,707,940

Vesting criteria required on vesting date three years after grant date are set out below:

\* Shares conditionally awarded during 2012 and 2013 will vest in full if the share price is £1.00 or more on the vesting date. If the share price is £0.70 the award does not vest at all. If the share price is between £0.70 and £1.00 the award partially vests, on a straight line basis.

# Notes to the Consolidated Financial Statements *continued*

## 10. Share-based payment plans (continued)

The fair value of the award is estimated as at the date of award using a Monte Carlo model taking into account the terms and conditions upon which the shares were awarded

The following table lists the inputs into the model used for the shares awarded in the year and the prior year

Grant date	26 March 2013
Share price at date of award	58.0p
Exercise price	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	23%
Vesting period (years)	3.0
Expected dividend yield	0%
Risk-free discount rate	1.0%
Fair value per share awarded	16p

The weighted average remaining contractual life for the conditional share awards outstanding at 31 December 2014 is four months (2013 one year and two months)

### c) Enterprise Management Incentives (EMI) options

Under this scheme share options are granted at nil exercise price to senior management. The options may be exercised after three years to the extent that certain market and non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse. Options expire after 10 years and in certain circumstances, are forfeited if the option holder leaves the Group before the options vest. The movement in the number of EMI options is set out below

	2014
At 1 January	2,047,060
Granted	100,000
Lapsed	—
Forfeited	(150,000)
At 31 December	1,997,060

The fair value of the award is estimated as at the date of award using Monte Carlo (where there are market conditions) and Black-Scholes models (where there are no market conditions) taking into account the terms and conditions upon which the shares were awarded. The weighted average fair value of EMI options granted during the year was 29p (2013 39p). The following table lists the inputs into the model used for the options granted in the year

Grant date	28 April 2014	26 March 2013
Share price at date of award	29.0p	58.0p
Number of options	100,000	2,047,060
Exercise price	£nil	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	29%	23%
Vesting period (years)	3.0	3.0
Expected dividend yield	0%	0%
Risk-free discount rate	1.0%	1.0%
Weighted average fair value per share awarded	29p	39p

### d) Cash-settled options

Under this scheme the Company grants employees the right to receive a cash award subject to the fulfilment of certain vesting conditions, equal to the vesting date market value of the notional shares awarded to the employees.

The options may be exercised after three years to the extent that certain non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse. Options expire after 10 years and in certain circumstances are forfeited if the option holder leaves the Group before the options vest.

	2014
At 1 January	200,000
Granted	—
At 31 December	200,000

The fair value of the award is estimated as at the date of award using a Black-Scholes model, taking into account the terms and conditions upon which the shares were awarded. The weighted average fair value of cash-settled options granted during the year was nil (2013 52.88p).

The following table lists the inputs into the model used for the cash settled options granted in the year.

Grant date	11 June 2013	26 March 2013
Share price at date of award	47.75p	58.0p
Number of options	100,000	100,000
Exercise price	£nil	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	23%	23%
Vesting period (years)	3.0	3.0
Expected dividend yield	0%	0%
Risk-free discount rate	1.0%	1.0%
Fair value per share awarded	47.75p	58p

## 11. Auditors' remuneration

	2014 £000	2013 £000
Audit of Company and consolidated financial statements	36	34
Audit of subsidiaries	45	45
Total audit	81	79
Tax compliance services	29	29
Tax advisory services	—	4
Services relating to taxation	29	33
Total non audit services	29	33
Total fees	110	112

## 12. Finance income and costs

	2014 £000	2013 £000
Finance income		
Bank interest receivable	50	129
Gains on translation of foreign bank and intercompany balances	128	—
Total finance income	178	129
Finance costs		
Foreign exchange losses	—	(22)
Total finance costs	—	(22)
Net finance income	178	107

The Company has a sterling denominated loan to Modern Water Inc, its subsidiary in the US. Movement in the sterling/US dollar exchange rate results in foreign exchange gains or losses which are recorded as finance income or cost. The US dollar strengthened during the year and consequently resulted in an exchange gain in finance income. During the prior year the US dollar weakened and consequently this arrangement resulted in an exchange loss of £48k which was recorded within administrative expenses.

# Notes to the Consolidated Financial Statements *continued*

## 13. Taxation

### 13.1 Tax on loss on ordinary activities

	2014 £000	2013 £000
Deferred tax		
Origination and reversal of temporary differences	(26)	(45)
Impact of change in the UK tax rate	(10)	(21)
<b>Total deferred tax</b>	<b>(36)</b>	<b>(66)</b>

### 13.2 Reconciliation of the total tax charge

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to losses of the consolidated entities as follows.

	2014 £000	2013 £000
Loss on ordinary activities before taxation	17,717	4,766
Loss multiplied by the weighted average tax rate of 21.5% (2013: 23.25%)	3,809	1,108
Expenses not deductible for tax purposes	(2,601)	(40)
Capital allowances and other timing differences	(57)	(87)
Adjustment in respect of prior years	27	51
Re-measurement of deferred tax – changes in UK tax rate	10	21
Losses not utilised	(1,152)	(987)
<b>Tax (debit)/credit</b>	<b>36</b>	<b>66</b>

### 13.3 Deferred tax liabilities

	2014 £000	2013 £000
<b>Intangible assets in business combinations</b>		
At 1 January	234	300
Credited to the statement of comprehensive income	(36)	(66)
<b>At 31 December</b>	<b>198</b>	<b>234</b>

The deferred tax liability arises from taxable temporary differences on intangible assets recognised on business combinations and is expected to unwind over the useful economic life of these assets. The analysis of deferred tax liabilities is as follows:

	2014 £000	2013 £000
To be recovered after more than 12 months	176	208
To be recovered within 12 months	22	26
<b>Deferred tax liabilities</b>	<b>198</b>	<b>234</b>

Deferred tax assets of £5,238,000 at 31 December 2014 (31 December 2013: £4,691,000) in respect of unutilised trading losses have not been recognised as utilisation is not yet sufficiently certain. No deferred tax assets relating to short-term timing differences or depreciation in excess of capital allowances have been recognised, due to uncertainty over the timing of the recovery of these assets.



**14. Loss per share****14.1 Basic**

Basic loss per share (LPS) is calculated by dividing the loss attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year

	2014	2013
Loss attributable to owners of the parent (£000)	17,681	4,700
Weighted average number of ordinary shares in issue (thousands)	79,505	76,108
Basic loss per share	22.24p	6.18p

**14.2 Diluted**

As the Group is loss making, the diluted loss per share is equal to the basic loss per share

**15. Property, plant and equipment**

Group	Leasehold improvements £000	Plant and machinery £000	Motor vehicles £000	Office equipment £000	Furniture, fixtures and fittings £000	Total £000
<b>At 1 January 2013</b>						
Cost	390	1,314	46	363	200	2,313
Accumulated depreciation	(138)	(881)	(21)	(223)	(127)	(1,390)
Net book amount	252	433	25	140	73	923
<b>Year ended 31 December 2013</b>						
Opening net book amount	252	433	25	140	73	923
Exchange differences	(2)	(3)	—	—	—	(5)
Additions	12	110	—	12	10	144
Disposals	—	(20)	—	—	(2)	(22)
Depreciation charge	(61)	(295)	(12)	(50)	(27)	(445)
Closing net book amount	201	225	13	102	54	595
<b>At 31 December 2013</b>						
Cost	400	1,401	46	375	208	2,430
Accumulated depreciation	(199)	(1,176)	(33)	(273)	(154)	(1,835)
Net book amount	201	225	13	102	54	595
<b>Year ended 31 December 2014</b>						
Opening net book amount	201	225	13	102	54	595
Exchange differences	8	6	—	3	—	17
Additions	—	71	—	25	—	96
Disposals	—	(8)	—	—	—	(8)
Depreciation charge	(59)	(113)	(9)	(50)	(25)	(256)
Closing net book amount	150	181	4	80	29	444
<b>At 31 December 2014</b>						
Cost	408	1,468	46	403	208	2,533
Accumulated depreciation	(258)	(1,287)	(42)	(323)	(179)	(2,089)
Net book amount	150	181	4	80	29	444

There were no property plant and equipment assets recognised in the Company's Statement of Financial Position as at 31 December 2014 (2013 none)

# Notes to the Consolidated Financial Statements *continued*

## 16. Intangible assets

Group	Goodwill £000	Patent and trademark costs £000	Development costs £000	Research and development, and patented technology acquired as part of a business combination £000	Customer contracts acquired as part of a business combination £000	Total £000
<b>At 1 January 2013</b>						
Cost	13,434	794	131	4,007	180	18,546
Accumulated amortisation	—	(192)	(131)	(839)	(95)	(1,257)
Net book amount	13,434	602	—	3,168	85	17,289
<b>Year ended 31 December 2013</b>						
Opening net book amount	13,434	602	—	3,168	85	17,289
Additions	—	81	—	—	—	81
Disposals	—	(28)	—	—	—	(28)
Amortisation charge	—	(40)	—	(332)	(78)	(450)
Closing net book amount	13,434	615	—	2,836	7	16,892
<b>At 31 December 2013</b>						
Cost	13,434	847	131	4,007	180	18,599
Accumulated amortisation	—	(232)	(131)	(1,171)	(173)	(1,707)
Net book amount	13,434	615	—	2,836	7	16,892
<b>Year ended 31 December 2014</b>						
Opening net book amount	13,434	615	—	2,836	7	16,892
Additions	—	76	—	—	—	76
Disposals	—	(101)	—	—	—	(101)
Impairment charge	(11,902)	—	—	(688)	—	(12,590)
Amortisation charge	—	(47)	—	(331)	(7)	(385)
Closing net book amount	1,532	543	—	1,817	—	3,892
<b>At 31 December 2014</b>						
Cost	13,434	923	131	4,007	180	18,675
Accumulated amortisation and impairment charge	(11,902)	(380)	(131)	(2,190)	(180)	(14,783)
Net book amount	1,532	543	—	1,817	—	3,892

Additions to patent costs arise from legal and other fees incurred in securing patents. These are valued at the actual costs related to prosecuting the patents.

The goodwill carrying value by CGU is summarised below:

Group	2014 £000	2013 £000
Surrey Aquatechnology Limited	—	11,902
Poseidon Water Limited	140	140
Cymtox Limited	629	629
Modern Water Monitoring Limited (previously Cogent Environmental Limited)	663	663
AguaCure Ltd	100	100
<b>Total Group goodwill</b>	<b>1,532</b>	<b>13,434</b>

Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired

An impairment charge of £11,902,000 to goodwill and £688,000 to research and development costs has been made to reflect uncertainty over the size and timing of contract revenue and cashflow from the Membrane division (Surrey Aquatechnology Limited). This has been recorded as an exceptional item given its significance. The Directors have decided to record a non-cash impairment to goodwill and intangibles in the Membrane division, in view of the time that it is taking to close commercial contracts and gain customer acceptance of our products and processes in combination with the closing market capitalisation of Modern Water plc at 31 December 2014. These assets were initially created by the acquisition of Surrey Aquatechnology Limited for the non-cash consideration of 10.8m Modern Water plc shares in June 2007.

The goodwill impairment review indicated that the recoverable amounts for all other CGUs are in excess of the carrying value. The forecasts indicate sufficient headroom between the recoverable amount and carrying value to allow for movement in the key assumptions before impairment is required. Therefore no further goodwill impairment was recorded in the year.

The recoverable amounts are determined using the higher of the cash generating units (CGU) fair value less costs of disposal (FV) and value in use (VIU) calculations. The fair value less costs of disposal method calculates the fair value of each CGU based on the Company's share price and the selling prices of comparable businesses. The VIU method requires the estimation of future cash flows before tax and the selection of a suitable discount rate in order to calculate the present value of these cash flows. The cash flow calculations analyse the present value of applying Modern Water's patented technology to potential contracts in the future.

Modern Water is in the early commercial development stage, with the exception of the established businesses of Modern Water Inc and Modern Water Monitoring Limited in developing markets. The Group is currently working to secure and increase revenue generating contracts in both the Membrane and Monitoring divisions. Forecast sales and profit are dependent on the size of the markets, penetration and speed of uptake. The early stage of adoption means that there remains a significant level of judgement involved in making assumptions for sales.

The key assumption for both the Cymtox Limited and Modern Water Monitoring Limited value in use calculations are the sales volumes. Management estimates the sales volume based on the current business plan, which was approved by the Board. The business plan was based on both historical sales and also future sales forecasts from customers. Discount rates of 15% (2013: 15%) and 15% (2013: 15%) respectively have been applied.

The key assumption for both Poseidon Water Limited and Aguacure Ltd value in use calculations is the securing of wastewater contracts over the next five years. Management estimates the sales volume based on the current business plan which was approved by the Board. The business plan was based on forecasts from potential customers. A discount rate of 20% (2013: 20%) and 20% (2013: 20%) respectively has been applied.

The discount rates applied to each CGU for the value in use projections are between 15% and 20% as outlined above (2013: 15% to 20%). All assumptions have been reviewed at the end of the year and revised where necessary.

There were no intangible assets recognised in the Company's Statement of Financial Position as at 31 December 2014 (2013: none).

# Notes to the Consolidated Financial Statements *continued*

## 17. Investments

Company	Investment in subsidiary £000
<b>Year ended 31 December 2013</b>	
Opening book amount	15,825
Capital contribution relating to share-based payments	93
Closing book amount	15,918
<b>Year ended 31 December 2014</b>	
Opening book amount	15,918
Capital contribution relating to share-based payments	123
Impairment charge	(13,344)
Closing book amount	2,697

The impairment charge is for the investment which the Company has in Surrey Aquatechnology, equivalent to the impairment of goodwill and intangibles in the Group intangibles balance as described in note 16

Subsidiary undertakings, which contribute to the group result	Principal activities	% Shareholding	Status
Modern Water Services Limited	Technical, business development finance, legal and admin services to the Group companies	100	Subsidiary
Surrey Aquatechnology Limited	Desalination technology	100	Subsidiary
Modern Water Holdings Limited	Holding company for water treatment operating companies and investments	100	Subsidiary
Modern Water Technology (Shanghai) Co. Ltd	Project and operating company in China	100	Subsidiary
Modern Water Technologies LLC	Project and operating company in Oman	70	Subsidiary
MW Monitoring Limited	Holding company for monitoring instrumentation business	100	Subsidiary
Modern Water Inc	Toxicity and environmental monitoring products	100	Subsidiary
MW Monitoring IP Limited	Owners of IP for toxicity and environmental monitoring products	100	Subsidiary
Modern Water Monitoring Limited	Water and soil monitoring products	100	Subsidiary
Cymtox Limited	Toxicity monitoring applications	100	Subsidiary
Aguacure Ltd	Electro-coagulation wastewater treatment systems	100	Subsidiary
Poseidon Water Limited	Saline wastewater treatment systems	51	Subsidiary
Modern Water (Nominees) Limited	Acquisition and allocation of shares for the Group	100	Subsidiary

Modern Water Inc is a Delaware corporation. Modern Water Technologies LLC is a company registered in Oman. Modern Water Technology (Shanghai) Co. Ltd is a company registered in China. All other subsidiaries are incorporated in England and Wales. Shares held are all ordinary share capital.

The Group had no investments in the current or prior year.

## 18. Inventories

	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
Raw materials	273	217	—	—
Work in progress	33	37	—	—
Finished goods	1,150	787	—	—
<b>Total inventories</b>	<b>1,456</b>	<b>1,041</b>	<b>—</b>	<b>—</b>

The cost of inventories recognised as expense and included in cost of sales amounted to £1,265,000 (2013: £1,307,000). The carrying value of inventories is net of a £104,000 provision for slow moving and obsolete inventories (2013: £82,000).

**19. Trade and other receivables**

	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
Trade receivables	794	1,077	—	—
Provision	(44)	(43)	—	—
Trade receivables – net	750	1,034	—	—
Value added tax	43	73	—	5
Accrued income	—	67	—	67
Other receivables	164	46	8	—
Amounts due from subsidiary undertakings	—	—	6,303	6,788
Amounts due from non-controlling interests	126	126	—	—
Prepayments	571	288	8	10
Total trade and other receivables	1,654	1,634	6,319	6,870

Accrued income includes interest due on term deposits. The amounts due from subsidiary undertakings are unsecured, bear no interest and are repayable on demand.

As at 31 December, Group trade receivables of £388,000 (2013: £334,000) were past due, of which £44,000 was provided against (2013: £43,000). The ageing of these receivables is as follows:

	Group	
	2014 £000	2013 £000
Up to 3 months past due date	216	218
3 to 6 months past due date	136	61
More than 6 months past due date	36	55
Trade receivables past due date	388	334
Trade receivables not yet due and not considered impaired	406	743
Total trade receivables	794	1,077

The carrying amounts of the Group's trade receivables are denominated in the following currencies:

	Group	
	2014 £000	2013 £000
UK pound sterling	139	151
US dollar	623	846
Omani rial	25	36
Australian dollar	—	4
Euro	7	40
	794	1,077

# Notes to the Consolidated Financial Statements *continued*

## 19. Trade and other receivables (continued)

Movements on the Group's provision for impairment of trade receivables are as follows

	Group	
	2014 £000	2013 £000
At 1 January	43	—
Provision for receivables impairment	1	43
Receivables written off during the year as uncollectable	—	—
	44	43

The Company had no trade and other receivables past due but not impaired (2013: £nil). The directors believe that the carrying value of the Company's receivables from subsidiary undertakings is supported by their expected future cash flows.

## 20. Cash

### 20.1 Cash and cash equivalents

	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
<b>Cash and cash equivalents</b>				
Cash at bank	6,801	6,432	5,666	5,247
Short-term deposits	—	5,000	—	5,000
Cash at bank and in hand	6,801	11,432	5,666	10,247

### 20.2 Credit quality of cash and cash equivalents

		Group		Company	
		2014 £000	2013 £000	2014 £000	2013 £000
Short term	Long term				
P-1	AA	6,132	1,369	5,097	240
P-1	A	100	2,556	—	2,500
P-2	A	—	5,007	—	5,007
P-2	Baa	569	—	569	—
NP	Caa	—	2,500	—	2,500
Cash at bank and in hand		6,801	11,432	5,666	10,247

The credit quality of the cash and cash equivalents is assessed using Moody's short and long term ratings.

## 21. Trade and other payables

	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
<b>Current</b>				
Trade payables	360	331	24	2
Social security	57	51	16	15
Accruals and deferred income	835	622	201	149
Total trade and other payables	1,252	1,004	241	166

## 22 Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below. The fair value of the assets and liabilities is equal to their carrying value.

Group	2014	2013
	Loans and receivables £000	Loans and receivables £000
Assets as per statement of financial position		
Trade and other receivables*	1,040	1,273
Cash and cash equivalents	6,801	11,432
Total	7,841	12,705

	Financial liabilities amortised at cost £000	Financial liabilities amortised at cost £000
Liabilities as per statement of financial position		
Trade and other payables**	1,195	953
Total	1,195	953

Company	2014	2013
	Loans and receivables £000	Loans and receivables £000
Assets as per statement of financial position		
Trade and other receivables*	6,311	6,855
Cash and cash equivalents	5,666	10,247
Total	11,977	17,102

	Financial liabilities amortised at cost £000	Financial liabilities amortised at cost £000
Liabilities as per statement of financial position		
Trade and other payables**	225	151
Total	225	151

\* excludes prepayments and VAT

\*\* includes accruals, but excludes any VAT and social security

Included in the cash and cash equivalents of the Group and Company at 31 December 2014 was the equivalent of £344,000 (2013 £537,000) denominated in US dollars, £254,000 (2013 £202,000) denominated in euros, £114,000 in Omani Rials (2013 £228,000), £146,000 in Australian dollars (2013 £110,000) and £35,000 in Chinese Yen (2013 £nil). The balance was denominated in pounds sterling (£). See note 19 for denomination of trade receivables by currency.

# Notes to the Consolidated Financial Statements *continued*

## 23. Commitments and contingencies

### 23.1 Group operating leases

Future aggregate minimum lease payments under non-cancellable operating leases as at 31 December are as follows

	Group	
	2014 £000	2013 £000
Not later than one year	331	359
After one year but not more than five years	458	783
Later than five years	—	—
<b>Group operating leases</b>	<b>789</b>	<b>1,142</b>

The Group's operating leases relate to property and office equipment and have remaining terms up to five years. The amount recognised as an expense in the year is £441,000 (2013: £384,000). The Company does not have any operating lease commitments (2013: none).

### 23.2 Contractual commitments

The Group consolidates some of its purchases and as such has a contractual commitment with one supplier to place orders for goods and services to the value of AUS\$2m per annum for 2015.

### 23.3 Contingent liabilities

Neither the Group nor the Company had any contingent liabilities at the balance sheet date (2013: £nil).

## 24. Share capital and premium

Group and Company	Authorised ordinary shares of 0.25p each Number	Allotted and fully paid ordinary shares Number	Authorised ordinary shares £000	Allotted and fully paid ordinary shares £000	Share premium £000	Total £000
At 1 January 2013	100,000,000	59,505,256	250	149	30,532	30,681
New share placing	—	20,000,000	—	50	9,500	9,550
At 31 December 2013	100,000,000	79,505,256	250	199	40,032	40,231
At 31 December 2014	100,000,000	79,505,256	250	199	40,032	40,231

On 12 February 2013 the Company announced the conditional placing of 20,000,000 new shares of 0.25p each. The shares were admitted to trading in two tranches on 1 March 2013 and 4 March 2013.

## 25. Net cash flows used in operating activities

Note	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
Loss on ordinary activities before taxation	(17,717)	(4,766)	(18,616)	(5,449)
Adjustments for:				
Depreciation of property plant and equipment	15 256	445	—	—
Amortisation of intangible assets	16 385	450	—	—
Loss on disposal of property plant equipment and intangible assets	109	40	—	—
Goodwill, intangibles and investment impairment	16, 17 12,590	—	13,344	—
Net finance income	12 (178)	(107)	(53)	(126)
Share-based payments	10 178	173	65	70
Movements in working capital:				
(Increase)/decrease in inventories	18 (382)	28	—	—
Decrease/(increase) in trade and other receivables	19 157	47	551	930
Increase(decrease)/ in trade and other payables	21 86	(33)	75	43
<b>Cash used in operations</b>	<b>(4,516)</b>	<b>(3,723)</b>	<b>(4,634)</b>	<b>(4,532)</b>



## 26. Related party transactions

IP Group plc held 20.0% of the ordinary share capital of the Company as at 31 December 2014 and appoints a non-executive director, and it is therefore deemed a related party. A service agreement dated 1 December 2006 was made between the Company and IP Group plc, whereby IP Group plc provides strategic, business development and administrative services to the Company. Fees for the year were £30,000 (2013 £30,000) and as at 31 December 2014 £7,500 (2013 £7,500) was outstanding under this agreement.

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation in the Group accounts, but require disclosure in the Company accounts.

An agreement dated 30 November 2006 was made between the Company and Surrey Aquatechnology Limited for the provision of administrative services for fees of £6,000 per annum. At 31 December 2014, fees of £6,000 (2013 £6,000) were outstanding under this agreement.

An agreement dated 14 December 2006 was made between the Company and Cymtox Limited for the provision of administrative services for fees of £14,463 per annum. At 31 December 2014, fees of £14,000 (2013 £14,000) were outstanding under this agreement.

An agreement dated 14 December 2006 was made between the Company and Poseidon Water Limited for the provision of administrative services for fees of £50,760 per annum. At 31 December 2014, fees of £55,000 (2013 £55,000) were outstanding under this agreement.

Additionally the Company had receivable balances at 31 December 2014 with its subsidiary companies to fund working capital and acquisition of investments as follows:

- Modern Water Services Limited – £19,653,000 (2013 £17,045,000). This has been fully provided against as at 31 December 2014.
- Surrey Aquatechnology Limited – £1,249,000 (2013 £1,199,000). This has been fully provided against as at 31 December 2014.
- MW Monitoring Limited – £5,001,000 (2013 £4,693,000).
- Modern Water Monitoring Limited – £2,964,000 (2013 £2,315,000). This has been fully provided against as at 31 December 2014.
- Cymtox Limited – £650,000 (2013 £269,000).
- AguaCure Ltd – £184,000 (2013 £181,000).
- Poseidon Water Limited – £112,000 (2013 £105,000).
- Modern Water Holdings Limited – £287,000 (2013 £265,000).

# Notice of Annual General Meeting

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## **Modern Water plc**

(Incorporated and registered in England and Wales with registered number 5963927)

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. IF YOU ARE IN ANY DOUBT AS TO ANY ASPECT OF THE CONTENTS OF THIS DOCUMENT OR THE ACTION YOU SHOULD TAKE YOU ARE RECOMMENDED TO CONSULT AN INDEPENDENT ADVISER AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000.

## **Notice of Annual General Meeting**

Notice is hereby given that the Annual General Meeting of Modern Water plc will be held at the offices of the Company Bramley House The Guildway Old Portsmouth Road Guildford Surrey GU3 1LR on Thursday 30 April 2015 at 10.00 a.m. to consider and, if thought fit to pass the following resolutions, of which resolutions 1 to 5 will be proposed as ordinary resolutions and resolutions 6 and 7 will be proposed as special resolutions.

## **Ordinary resolutions**

- 1 To receive the directors' report, the accounts and the Auditors' report for the financial year ended 31 December 2014
- 2 To receive and approve the directors' remuneration report for the year ended 31 December 2014
- 3 To re-appoint PricewaterhouseCoopers LLP as Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next general meeting of the Company at which accounts are laid before the shareholders and to authorise the directors to fix their remuneration
- 4 To re-elect as a director of the Company Mr Michael Gradon, who retires by rotation
- 5 **THAT** the directors be generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 ("the Act") to exercise all the powers of the Company to allot equity securities (as defined in section 560 of the Act)
  - a up to an aggregate nominal amount of £66,254 (being one third of the nominal value of the issued share capital of the Company as at 10 March 2015) and in addition
  - b up to a further aggregate nominal amount of £66,254 (being one third of the nominal value of the issued share capital of the Company as at 10 March 2015) in connection with a rights issue in favour of holders of shares in proportion as nearly as is practicable to their existing holding and holders of other equity securities (to the extent that this is required by the rights of those securities or is permitted by those rights and considered necessary by the directors) subject only to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates, shares represented by depositary receipts, legal or practical difficulties arising under the laws of any territory or the requirements of any relevant regulatory body or any stock exchange, or any other matter.

This authority shall operate in substitution for and to the exclusion of all previous authorities given to the directors pursuant to section 551 of the Act, and shall expire on the conclusion of the Company's 2016 Annual General Meeting (or if earlier 28 July 2016), except that the Company may before such expiry make any offer or agreement which would or might require relevant securities to be allotted after such expiry and notwithstanding such expiry the directors may allot relevant securities pursuant to any such offer or agreement.

**Special resolutions**

- 6 **THAT** subject to the passing of resolution 5 the directors be empowered in accordance with section 570 of the Companies Act 2006 (the Act') to allot equity securities (as defined in section 560 of the Act) payment for which is to be wholly in cash pursuant to the authority conferred by resolution 5 as if section 561 of the Act did not apply to any such allotment provided that this power shall be limited to
- a the allotment of equity securities in connection with a rights issue, or any other pre-emptive offer in favour of holders of shares in proportion as nearly as is practicable, to their existing holding and holders of other equity securities (to the extent that this is required by the rights of those securities or is permitted by those rights and considered necessary by the directors) subject only to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates, shares represented by depositary receipts legal or practical difficulties arising under the laws of any territory or the requirements of any relevant regulatory body or any stock exchange, or any other matter,
  - b the allotment (otherwise than pursuant to sub-paragraph a above) of equity securities up to an aggregate nominal value of £39,752.63 (being 20% of the nominal value of the issued share capital of the Company as at 10 March 2015)

This power shall operate in substitution for and to the exclusion of any previous power given to the directors pursuant to section 570 or 571 of the Act and shall expire at the same time as the authority in resolution 5, except that the Company may before such expiry make any offer or agreement which would or might require equity securities to be allotted after such expiry and notwithstanding such expiry, the directors may allot equity securities pursuant to any such offer or agreement

- 7 **THAT** a general meeting of the Company other than an Annual General Meeting may be called on not less than 14 clear days' notice

By order of the Board

**Toby Schumacher**  
Company Secretary  
Modern Water plc  
11 March 2015

Registered office  
Bramley House  
The Guildway  
Old Portsmouth Road  
Guildford  
Surrey GU3 1LR

Incorporated in England and Wales with registered number 5963927

## Notes

- 1 Members are entitled to appoint a proxy to exercise all or any of their rights to attend and to speak and vote on their behalf at the meeting. A shareholder may appoint more than one proxy in relation to the Annual General Meeting provided that each proxy is appointed to exercise the rights attached to a different share or shares held by that shareholder. A proxy need not be a shareholder of the Company. A proxy form to make such appointment and give proxy instructions accompanies this notice. If you do not have a proxy form and believe that you should have one, or if you require additional forms, please contact the Company's registrars, Capita Asset Services on 0871 664 0300 (calls cost 10p per minute plus network extras) or, if telephoning from overseas, on +44 208 639 3399. Lines are open 09:00 a.m. - 5:30 p.m. Monday to Friday.
- 2 To be valid, any proxy form or other instrument appointing a proxy must be received by post or (during normal business hours only) by hand not less than 48 hours before the time fixed for the meeting.
- 3 The return of a completed proxy form, other such instrument or any CREST Proxy Instruction (as described in paragraph 8 below) will not prevent a shareholder attending the Annual General Meeting and voting in person if he/she wishes to do so.
- 4 Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a 'nominated person') may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a nominated person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.
- 5 The statement of the rights of shareholders in relation to the appointment of proxies in paragraph 1 above does not apply to nominated persons. The rights described in that paragraph can only be exercised by shareholders of the Company.
- 6 To be entitled to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast), shareholders must be registered in the register of members of the Company at 18:00 on 28 April 2015 or, if the meeting is adjourned, 48 hours prior to the time fixed for the adjourned meeting. Changes to the register of members after that time shall be disregarded in determining the right of any person to attend and vote at the meeting.
- 7 CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members and those CREST members who have appointed a service provider(s) should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
- 8 In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with CREST's specifications and must contain the information required for such instruction as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy, must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10). 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 Application Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time, any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.
- 9 CREST members and, where applicable, their CREST sponsors, or voting service providers should note that CRESTCo does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
- 10 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.
- 11 As at 10 March 2015 (being the day on which the board approved this notice), the Company's issued share capital consisted of 79,505,256 ordinary shares carrying one vote each. Therefore, the total voting rights in the Company as at that time were 79,505,256.

# Form of proxy Modern Water plc

## Company Number: 5963927

Please read carefully the notice of meeting and explanatory notes set out below before completing this form  
Please complete this form in BLOCK CAPITALS

I/We (name) \_\_\_\_\_

of (address) \_\_\_\_\_

being member(s) of the above named Company hereby appoint the Chairman of the meeting or (see notes 1 5 and 7)

(name) \_\_\_\_\_

of (address) \_\_\_\_\_

as my/our proxy to vote for me/us and on my/our behalf at the Annual General Meeting of the Company to be held at the offices of the Company Bramley House The Guildway Old Portsmouth Road, Guildford GU3 1LR at 1000 a.m. on 30 April 2015 and at any adjournment thereof

I/we direct my/our proxy to vote as indicated by an 'X' in the appropriate column (note 2)

Ordinary resolutions		For	Against	Withheld
1	To receive the directors' report the audited statement of accounts and Auditors' report of the Company for the financial year ended 31 December 2014			
2	To receive and approve the directors' remuneration report for the year ended 31 December 2014			
3	To reappoint PricewaterhouseCoopers LLP as Auditors of the Company and to authorise the directors of the Company to fix their remuneration			
4	To re-elect Michael Gradon as a director of the Company who is retiring by rotation and offering himself for re-election			
5	To authorise the directors to allot equity securities up to a nominal amount of £66,254 and in addition by way of fully pre-emptive rights issue, up to a nominal amount of £66,254			
Special resolutions		For	Against	Withheld
6	To authorise the directors to allot equity securities for cash, disapplying the statutory pre-emption rights up to a nominal amount of £39,752.63 (being 20% of the issued capital)			
7	To call a general meeting (other than AGM) on not less than 14 days' notice			

Signature(s) and/or common seal (notes 3 and 4) \_\_\_\_\_

Date \_\_\_\_\_ 2015

### Notes

1. A proxy need not be a member of the Company. Completion and return of this form of proxy does not preclude a member from subsequently attending and voting at the meeting. If you wish to appoint a proxy other than the Chairman of the meeting, please cross out the words 'the Chairman of the meeting or' and write the full name and address of your proxy in the space provided. The change should be initialled.
2. If you do not indicate how you wish your proxy to vote on any resolution or on any other matter (including any amendment to any resolution) the proxy will exercise his/her discretion as to how he/she votes and as to whether or not he/she abstains from voting in such manner as he/she thinks fit.
3. This form must be signed and dated by the shareholder or his/her attorney duly authorised in writing. In the case of a corporation this form of proxy must be executed under its common seal or under the hand of an officer or attorney duly authorised in writing.
4. A form of proxy to be valid must be signed and dated and must be lodged together with the power of attorney or other authority (if any) under which it is signed or a duly certified copy of such power or authority with the Company's registrars at Capria Asset Services PXS1 34 Beckenham Road, Beckenham, Kent BR3 4ZF not less than 48 hours before the time fixed for the meeting.
5. In the case of joint holders the signature of any one of them will suffice but the names of all joint holders should be stated. The vote of the senior who tenders a vote (whether in person or by proxy) will be accepted to the exclusion of the votes of the other holders. For this purpose seniority is determined by the order in which the names stand in the register of members in respect of the joint holding.
6. Any alteration to this form must be initialled.
7. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting is 1800 on 28 April 2015 or if the meeting is adjourned 48 hours prior to the time fixed for the adjourned meeting. Changes to the register of members after that time shall be disregarded in determining the right of any person to attend and vote at the meeting.

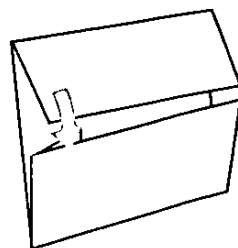
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34 Beckenham Road  
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BR3 4ZF

second fold

**Registered office**

Bramble House  
The Guildway  
Old Portsmouth Road  
Guildford  
Surrey  
GU3 1LR

**Company number**

Registered in England and Wales number 05963927

Further details can be found on the Modern Water website  
[www.modernwater.com](http://www.modernwater.com)

**Nominated adviser and broker**

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The London Stock Exchange Building  
10 Paternoster Square  
London  
EC4M 7LT

**Independent auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
The Portland Building  
25 High Street  
Crawley  
West Sussex  
RH10 1BG

**Solicitors**

Norton Rose Fulbright LLP  
3 More London Riverside  
London  
SE1 2AQ

**Registrars**

Capita Asset Services  
The Registry  
34 Beckenham Road  
Beckenham  
Kent  
BR3 4TU

**Principal bankers**

HSBC Bank plc  
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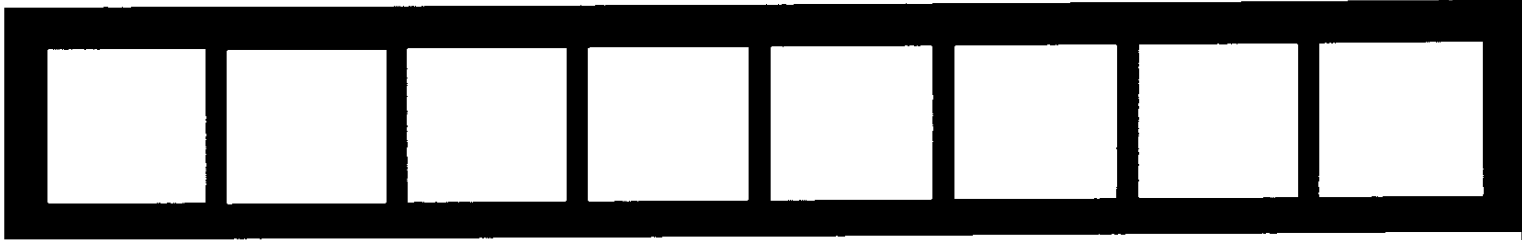


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[www.modernwater.com](http://www.modernwater.com)

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