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Powered by Ceres

Annual Report 2011

## Who we are

**Ceres Power is a leading developer of clean, efficient, cost-effective decentralised energy products that can help address the key energy challenges:**

- > Increase energy efficiency**
- > Reduce CO<sub>2</sub> emissions**
- > Increase energy security**
- > Reduce fuel poverty**

The Company was founded in 2001 to commercialise the unique core materials science technology developed at Imperial College during the 1990s

In November 2004, the Company went public on the Alternative

Investment Market of the London Stock Exchange. The Group's shareholders include a variety of UK and international financial institutions and private individuals. The largest shareholders include Oppenheimer, Centrica trading as British Gas and Imperial College

Today, Ceres Power directly employs more than 160 people with its operations based in the UK, comprising a Technology Centre in Crawley and a volume fuel cell manufacturing facility in Horsham, Sussex

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## What we do

**Ceres Power has developed a mass manufacturable technology platform: the Fuel Cell Module ('FCM'), using the Group's patented solid oxide fuel cell ('SOFC') technology and operating on mains natural gas or packaged fuels, such as LPG.**

Ceres Power's core FCM is a metal-supported solid state electro-chemical device which generates electricity and heat directly from fuel and air. Unlike the combustion process in an engine-driven generator, this solid state process is highly efficient,

environmentally friendly and quiet. The FCM will form the core of a range of distributed generation products designed to become the new standard for energy provision in millions of homes around the world and to be at the heart of low-carbon smart grids.

The FCM has been integrated within a compact wall-mounted residential Combined Heat and Power ('CHP') product that replaces the conventional residential boiler and also produces the majority of a typical home's electricity needs.

## CHP in the home

### **Our technology**

The patented Ceres fuel cell design comprises thin electrochemical layers deposited onto a porous stainless steel supporting substrate. The cell operates in the temperature range of 500–600°C which is substantially lower than the temperature at which conventional SOFC materials can operate typically 750–1,000°C. The inherently lower operating temperature of Ceres' unique SOFC technology enables the use of proven cost-effective materials and processes and a fuel cell stack design that is robust and resistant to thermal shock.

### **Our products**

The Group's first product is an integrated wall-mounted residential fuel cell CHP product. The compact product is designed to replace a conventional household boiler, using the same natural gas, water and electrical connections and with similar installation and maintenance requirements. The product is capable of generating all of the heat and hot water and the majority of the electricity for a typical UK home, saving the customer around 25% of their annual total energy costs and reducing the home's CO<sub>2</sub> emissions.

The Group manufactures in-house the high value core fuel cell technology and is partnering with well-established gas appliance manufacturers for CHP boiler assembly in accordance with Ceres' overall product design. Key balance of plant components and

sub-assemblies are co-developed and/or sourced in partnership with a global supply chain. This strategy enables the Group to maintain control of key intellectual property, maximise operational efficiency and earn 'product-level' revenues.

Ceres Power is a B2B company, partnering with major corporations such as British Gas, Calor Gas and Bord Gáis with well-established direct channels to millions of customers.

Significant market opportunities exist for the Group's residential CHP products globally including Europe, Asia and North America. New products and market opportunities also exist in the longer term beyond residential CHP, including tri-generation, remote industrial power and auxiliary power for transport applications.

### **Distributed generation**

A typical UK home uses electricity generated by a central power station and transmitted through the electricity grid network and uses a gas boiler to meet its heating and hot water needs. Centralised generation wastes a significant proportion of the energy it uses, through heat losses in the power station and transmission and distribution losses. A CHP product installed in a home and generating electricity at the point of use (so called distributed generation), avoids these energy losses, capturing the heat for use in domestic hot water and heating in the home. By creating

electricity at the point of use in the home, overall efficiency of fossil fuel use can be improved from around 35% for centralised generation to up to 90% for residential CHP. This increase in energy efficiency delivers significant reductions in carbon emissions.

### **Benefits of Ceres fuel cell technology**

A Ceres Power residential fuel cell CHP product has a low heat to power ratio. This means that even during the summer when the home's central heating system is turned off, the heat produced by the CHP product when generating electricity can be stored in a hot water cylinder and used for domestic hot water. Ceres' CHP is therefore capable of operating all year round, thereby maximising the energy bill savings through the generation of electricity throughout the year.

Unlike other fuel cell CHP technologies, a Ceres Power product can modulate its power output rapidly and automatically and follow a varying operating load, turning up and down or even on and off as needed. This enables a Ceres CHP product to generate the majority of the electricity requirements of a typical home and provide the ability to deliver truly despatchable power to respond to the grid's needs when it is under most strain and the electricity is most valuable.

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# Business Headlines

- > **David Pummell appointed as new Chief Executive Officer with effect from 5 September 2011**
- > **Significant improvements achieved in core fuel cell technology**
- > **Robust new plan to achieve first generation product launch in H1 2014**
- > **Global opportunity for Ceres Combined Heat and Power product remains substantial**
- > **£26.7m in net cash and short-term investments at 30 June 2011**

**Business  
Review**

# Chairman's Statement

I am pleased to report on the financial results and achievements of the Group for the year ended 30 June 2011. There have been some notable achievements that have moved the business forward but there have also been some setbacks in our progress to launching a mass market residential Combined Heat and Power ('CHP') product.

In March 2011, we reported that the initial in-home CHP field trial units had experienced reliability and durability issues. We have made significant progress in resolving all these issues but in order to accommodate the additional engineering activity the programme to complete testing and trialing and to achieve initial CHP product sales will take longer than originally planned.

I am pleased to report that during the last six months we have made substantial performance improvements in the core fuel cell technology. These improvements give us increased confidence in meeting the requirements for the mass market launch of our CHP product.

The Board is delighted to have appointed David Pummell as the Group's new Chief Executive Officer ('CEO'), who took up office on 5 September 2011. David was CEO of MAPS Technology Ltd, where he built

the company from an early-stage technology venture into a commercially successful business selling high-value engineered products and services. Prior to this, David held a number of senior executive roles in BP including leading the European fuels and lubricants business and various operational roles with responsibility for manufacturing, operations and distribution.

Since joining as CEO, David has conducted a comprehensive review of the business, the status of the core technology and the plan to commercialise the Group's CHP product. As described in the Chief Executive Officer's Review, we are today setting out a revised plan to conduct a second phase of in-home field trials in H2 2012 leading to the launch of our first generation CHP product in H1 2014. In parallel, the Group will commence work on developing the next generation CHP product by value engineering the current CHP design to achieve a low-cost, durable CHP product to meet mass market cost requirements and a planned launch date in H1 2016.

This revised plan means that the Group is likely to continue to incur losses at the operating level. The Board continues to monitor closely the existing cash resources, which stood at £26.7m at the year end, and the funding needs of the Group, and it is

anticipated that the Group will raise an initial tranche of further funding during the next twelve months.

## **Strategic overview**

Since my report last year, the macro environment for microgeneration has continued to improve. Energy prices have risen significantly and most commentators expect this trend to continue as the scale of the investment required to replace ageing infrastructure and deliver low-carbon energy is recognised. Gas is an abundant, clean, flexible fuel and is acknowledged as an important ingredient in the transition to achieving a low-carbon economy. Technologies such as microCHP that efficiently convert gas into usable heat and power on-site will become important as a strategic option for consumers and governments. Importantly, in an uncertain world where technology is continuously advancing, an option for flexible, cleaner energy production with a typical life of up to ten years provides a lower risk option compared to large centralised power generation where investments typically have a life of 25 years or more and require considerable investment in the transmission systems to deliver the energy to the consumer.

Against this background, the market potential for residential CHP is substantial. Ceres Power's low-cost,

**Business  
Review**

# Chief Executive Officer's Review

I am delighted to join Ceres Power as Chief Executive Officer and excited by the global potential of the Ceres Combined Heat and Power ('CHP') product and the opportunity to lead this Group to a successful and vibrant future delivering significant value to all its stakeholders

My first priority, since my appointment in September 2011, has been to conduct a detailed review of the business and the plan to achieve mass market uptake of the Group's CHP product, with specific focus on the status of the core technology and our internal product validation programme. Ceres Power has had a challenging year and although there have been setbacks which have had an impact on the commercialisation timeline, we should not lose sight of the enormous progress that has been made in the development of our low-cost, wall-mounted residential fuel cell CHP product and the platform this now provides to mass market uptake of the technology

In September 2010, we demonstrated a compact CHP unit installed on a kitchen wall delivering heat for hot water and central heating and

generating electricity on demand powering a range of domestic appliances. The unique ability of the CHP fuel cell product to respond automatically and rapidly to real-time changing energy needs in the home was also demonstrated. Our partner British Gas has confirmed that the ability of the CHP product to increase or decrease power output on demand will enable access to the broadest range of UK households as target customers and will be of significant value to energy utility companies

During Q1 2011, and in partnership with British Gas, Ceres completed the installation of five CHP units in family homes across South East England directly replacing the existing conventional gas boilers. The field trial units delivered central heating, hot water and power to the homes and controlled themselves automatically, responding in real-time to the home's energy needs using a combination of the CHP unit's Fuel Cell Module ('FCM') and boiler. The purpose of this first wave of field trials was to gain valuable real-world experience and to identify issues ahead of deploying the next wave of field trial units in consumers' homes

**"We believe that Ceres Power's innovative technology has the potential to offer a unique value proposition. We are working closely with Ceres Power to bring their CHP product to our customers in the UK and enable them to generate flexible, low-carbon electricity in their own home and reduce their energy bills."**

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Against this background the market potential for residential CHP is substantial. Ceres Power's low-cost

Housing in the UK accounts for 27% of the country's total carbon emissions, the largest single element<sup>1</sup>

wall-mounted CHP product allows the Group to access the annual boiler replacement market and offer consumers the opportunity to generate low-carbon electricity in their own homes with an attractive payback. In Europe alone there are approximately 8 million residential boilers replaced every year and Ceres Power has already secured market access to millions of consumers in the UK and Ireland through its partnerships with British Gas, Calor Gas and Bord Gáis. We intend to develop further commercial partnerships in Europe and beyond to address the global market opportunity of more than 18 million units annually.

#### **Feed-in-Tariff and support for microgeneration technologies**

In the UK, the Government has recognised the importance of trying to achieve lower cost ways to reduce carbon rather than a single focus on maximising the deployment of higher cost renewables. In February 2011, the UK Government's Department of Energy and Climate Change ('DECC') announced a review of the Feed-in-Tariff ('FIT'), which is expected to realign the FIT to stimulate the uptake of the most cost-effective technologies.

As part of this review, a group of the leading microCHP developers and energy companies in the UK,

including Ceres Power and British Gas, has submitted a report to DECC recommending changes to the existing FIT structure to further encourage the uptake of microCHP. The report recommends that the current generation FIT of 10p/kWh should be raised to at least 15p/kWh with a volume-based reduction going forward, and that the current cap of 30,000 units should be lifted. Implementing this recommendation would stimulate faster adoption of microCHP, with the tariff reducing as the technologies are adopted and the benefits of the volume-related cost-down curve are captured.

We welcome this review and look forward to working with DECC and demonstrating the sustainable benefits of our technology for both the retrofit and new build housing sectors. The outcome of the review is expected to take effect in April 2012.

#### **People**

On behalf of the Board I would like to thank our employees for their commitment and determination. We have built a team of dedicated and talented people and they are rightly proud of what they have achieved. Bringing a new technology to market involves discovery, innovation and significant engineering effort and is never a straightforward

journey, but the opportunities for our technology are substantial.

#### **Summary**

The technology is capable of delivering flexible, clean power generation in an integrated and wall-mounted residential CHP product and we believe that this CHP product can be engineered into a low-cost, reliable fuel cell CHP product for the residential mass market.

The key task for the business is to complete the development, trialing and launch of a low-cost, durable CHP product that provides the consumer with clean, economic energy on demand. We have made considerable progress towards this goal and our new CEO, David Pummell, sets out in more detail in his review the key priorities for the Group over the next twelve months that underpin the route to achieving initial sales and creating the platform for mass market uptake thereafter.

**Brian Count**  
Chairman  
11 October 2011

<sup>1</sup> CLG – Definition of Zero Carbon Homes and Non-Domestic Buildings - December 08

# Chief Executive Officer's Review

I am delighted to join Ceres Power as Chief Executive Officer and excited by the global potential of the Ceres Combined Heat and Power (CHP) product and the opportunity to lead this Group to a successful and vibrant future delivering significant value to all its stakeholders

My first priority since my appointment in September 2011, has been to conduct a detailed review of the business and the plan to achieve mass market uptake of the Group's CHP product with specific focus on the status of the core technology and our internal product validation programme. Ceres Power has had a challenging year and although there have been setbacks which have had an impact on the commercialisation timeline, we should not lose sight of the enormous progress that has been made in the development of our low-cost wall-mounted residential fuel cell CHP product and the platform this now provides to mass market uptake of the technology.

In September 2010, we demonstrated a compact CHP unit installed on a kitchen wall delivering heat for hot water and central heating and

generating electricity on demand powering a range of domestic appliances. The unique ability of the CHP fuel cell product to respond automatically and rapidly to real-time changing energy needs in the home was also demonstrated. Our partner British Gas has confirmed that the ability of the CHP product to increase or decrease power output on demand will enable access to the broadest range of UK households as target customers and will be of significant value to energy utility companies.

During Q1 2011, and in partnership with British Gas, Ceres completed the installation of five CHP units in family homes across South East England directly replacing the existing conventional gas boilers. The field trial units delivered central heating, hot water and power to the homes and controlled themselves automatically, responding in real-time to the home's energy needs using a combination of the CHP unit's Fuel Cell Module (FCM) and boiler. The purpose of this first wave of field trials was to gain valuable real-world experience and to identify issues ahead of deploying the next wave of field trial units in consumers' homes.

**"We believe that Ceres Power's innovative technology has the potential to offer a unique value proposition. We are working closely with Ceres Power to bring their CHP product to our customers in the UK and enable them to generate flexible, low-carbon electricity in their own home and reduce their energy bills."**

Gearóid Lane, Managing Director of  
British Gas New Markets

By designing our product to retrofit in place of a conventional heating appliance, Ceres Power can access an existing market of more than 18 million units per annum globally<sup>2</sup>

### Technology progress

The Group has made substantial progress in a number of different areas relating to the core fuel cell technology. Significant improvements have been achieved in reducing the rate of power degradation and increasing long-term cell durability under real-world operating conditions

In March 2011, the Group reported that the in-home field trial units had experienced reliability and durability issues. We have made significant progress in resolving all these issues

- > boiler tuning and calibration issue causing ignition lock-out has been addressed,
- > shutdown of FCMs due to water management has been addressed,
- > interconnect corrosion and resulting power degradation has been addressed with an improved coating through better control of the heat treatment process
- > debris from FCM insulation causing power degradation has been addressed. There is no evidence of any ongoing impact on FCM power degradation. Testing is continuing to determine the impact, if any, of low level contaminants on long-term degradation,

- > cell delamination has been addressed through minor modifications to cell chemistry and refinements to the operating strategy. Development and testing work is under way to further strengthen cell layers and optimise performance, and
- > the operating strategy of the FCM used in the initial field trials has been confirmed as a significant cause of power degradation. A revised operating strategy has been developed and, in conjunction with improved measurement of operating temperature and tighter control of water and fuel flow to the stack, has significantly reduced the power degradation mechanism. These improvements are currently being validated and the operating strategy optimised.

Analysis of the power degradation measured in cells operating in the initial field trial CHP units showed that a significant root cause of power loss was cyclic oxidation of the anode. This can occur when fuel is interrupted and electronic and physical leakage is present in the cells. The Group has virtually eliminated electronic leakage and significantly

reduced physical leakage of the cells through minor modifications to cell layer chemistry and improved control of the fuel cell manufacturing process. Reducing cell leakage has also increased the cell operating potential to near theoretical limits which reduces the cell heat to power ratio to the lowest levels possible.

The new generation of cells has been subjected to aggressive accelerated stack testing under conditions which stress the anode interface through multiple hot relight and load cycling events. The new cells have shown a substantial improvement, with stacks consistently withstanding over 1,000 hot relight events with minimal degradation compared to the rapid degradation measured in the previous cell generation used in our initial field trials. The robustness of the new cells to load cycling was demonstrated using an FCM running on methane subjected to an accelerated test plan of 800 rapid load cycles. No measurable degradation was recorded providing validation of the cell's tolerance to electronic stresses caused by load cycling.

## Chief Executive Officer's Review

Continued

## Business Review

In July 2011 Ceres Power welcomed the Minister of State for Business and Enterprise Mark Prisk MP to conduct the official opening of its volume fuel cell manufacturing facility in Horsham

Ceres Power has created more than 160 highly skilled 'Green Collar' jobs at the manufacturing facility in Horsham and the technology centre in Crawley. As part of the Group's plans for a mass market launch of the CHP product in the UK, the manufacturing facility could be expanded to produce up to 30,000 fuel cell CHP products per annum, creating substantial additional skilled jobs in advanced manufacturing engineering, manufacturing operations and in the local supply chain. There are also significant export opportunities for Ceres CHP products globally.

During the visit, the Minister saw fuel cells being manufactured and CHP products being assembled and undergoing testing in the Group's new test facilities.

Mark Prisk MP, Minister of State for Business and Enterprise said: "It is thanks to innovative research and product development by companies such as Ceres Power that we are leading the world with this sort of technology and which will help us realise our ambition to make the UK a leading high-tech, highly skilled economy."

Water and fuel flows and temperatures are highly integrated and therefore must all operate in concert to provide accurate delivery and control of conditions within the FCM. Improvements have been made in the accuracy of the flow and measurement control of both water and fuel in the system through minor hardware and software changes. By adopting operating strategies which are compatible with the operating tolerances of the entire control system and which also prevent or minimise the likelihood of cell anode oxidation, we achieve significantly improved stack durability.

Taken in total, the improvements in cell leakage reduction, input control and operating strategy refinement have resulted in a significant step forward in achieving the long-term durability targets.

A significant contribution to long-term cell degradation is the gradual increase in cell electronic series resistance that is believed to arise from an increased level of metal

interconnect corrosion. The Group has developed improved interconnect designs which provide the same level of interconnect corrosion resistance and actually increase the power per cell. Short stack testing completed to date (~3,000hrs) with production interconnect coating materials and the optimised heat treatment conditions have achieved power and cell voltage degradation rates of 1%/1,000hrs. The Group will continue to perform both accelerated and long-term testing under all potential operating conditions in conjunction with the general field trial programme and we are confident of achieving further improvements in cell durability and long-term degradation.

### Route to achieve mass market uptake of Ceres CHP product

It is clear from my review that Ceres has unique technology and the potential to be a world-class company with the ability to lead the sector. I have been very impressed with the technical and operational capability in the business. Of significant note is that during the past two years,

the Group has undertaken to simultaneously develop its core technology, design and engineer the complete CHP product, whilst building a capable engineering and manufacturing organisation, this would be a challenge even for a well-established company.

We are now enhancing our organisational capability further and implementing improvements to key processes to reduce overall programme delivery risk, underpinning this will be an improvement in overall organisational effectiveness. These changes will improve the Group's competency to manage product programmes, rapidly solve product issues and deliver a low risk scale-up capability.

The current compact CHP design forms the basis of our first generation residential product.

This already integrates a boiler and FCM in a single wall-mounted unit and demonstrates a commercially distinctive size, weight and value.

More than 85% of the 1.5 million gas boilers installed in the UK every year are wall mounted<sup>3</sup>

**Ceres Power has world-leading technology and a highly differentiated commercial CHP product that is capable of widespread mass market adoption**

proposition to customers, which our UK market partner, British Gas believes are pre-requisites for a product to achieve widespread consumer adoption

The current CHP prototype validates the concept of a boiler-replacement consumer appliance that can be installed in the majority of the UK's homes and deliver significant energy bill savings, payments from the Feed-in-Tariff (FIT) and carbon reductions

We are today setting out a revised plan to launch a CHP product that meets the requirements of the mass market. The revised timeline, allowing the completion of value engineering, validation testing, performance optimisation and field trials, is as follows:

- > Second phase of in-home field trials in H2 2012
- > First generation sales of CHP product in H1 2014
- > Sales of the second generation mass market CHP product in H1 2016

The second phase of in-home field trials will now be conducted during H2 2012 to allow sufficient time to conduct CHP product and FCM testing and optimisation in the Group's test facilities to validate the product and demonstrate that the required performance levels of reliability and durability have been achieved

We plan to execute a launch in H1 2014 of our first generation CHP product that will validate the value proposition of this new product category. The initial product launch will also serve to understand how customers will use the product in their homes and what additional product refinements may need to be carried forward to further enhance the design of the mass volume launch product. Ceres and British Gas are working in collaboration to define the requirements necessary to access the early adopter segment in the UK that maximises our market understanding whilst minimising our commercial risk.

## Chief Executive Officer's Review

Continued

### Energy Supply Chain – Ceres CHP Value Proposition

| Energy Supply Chain                | Benefits from Ceres Power CHP Product                                                                                                        |
|------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Generation</b>                  | <ul style="list-style-type: none"> <li>&gt; Peak smoothing</li> <li>&gt; Reserve capacity to back up renewables</li> </ul>                   |
| <b>Transmission + distribution</b> | <ul style="list-style-type: none"> <li>&gt; Improved network utilisation</li> <li>&gt; Deferred asset upgrades</li> </ul>                    |
| <b>Energy supply</b>               | <ul style="list-style-type: none"> <li>&gt; Deliver on energy efficiency commitments</li> <li>&gt; Enable new energy propositions</li> </ul> |
| <b>Appliance installation</b>      | <ul style="list-style-type: none"> <li>&gt; Retention of existing boiler skills</li> <li>&gt; Rapid rollout</li> </ul>                       |
| <b>Consumer</b>                    | <ul style="list-style-type: none"> <li>&gt; Reduced energy costs</li> <li>&gt; Minimal disruption</li> </ul>                                 |
| <b>Government</b>                  | <ul style="list-style-type: none"> <li>&gt; Reduced emissions</li> <li>&gt; Improved energy security</li> <li>&gt; Reduced cost</li> </ul>   |

We will use the knowledge gained from customer services, supply chain management and manufacturing to inform the processes required to support the next generation product. This will be based on the same product system platform but will incorporate additional design and value engineering developments to achieve the cost and lifetime targets to secure mass volume uptake. In addition, work will continue with the supply chain to invest in tooling to deliver the mass volumes and component cost targets. We are confident that the inherent low-cost nature of our CHP design will enable these mass market targets to be achieved.

To de-risk the product development programme to achieve mass volume uptake of our CHP product, we will develop further our collaborations with existing partners and put in place new strategic partner collaborations within the value chain to enable the Group to access world class technical competencies and proven capabilities and successfully leverage their existing access to customers.

I believe this new timeline is achievable and represents a realistic plan for the Group. It is the best way to deliver a robust, reliable, value-engineered product that is shown to meet our partners' and customers' needs. As mentioned previously, the successful delivery of this revised timeline will require some important changes to the business. My task is to embed these changes quickly and reposition the Group as a high performing organisation without diverting our focus from delivering results.

#### Operations and manufacturing developments

During the year, fuel cell manufacturing capacity has been increased and quality improved with an additional furnace and cell production area upgrade. This increase in production capacity has enabled additional testing to be conducted and learning to be incorporated more rapidly. The key operational focus has been the establishment of repeatable production processes, improvements in fuel cell manufacturing quality and

reduction in production variation. These recent improvements have led to a manufacturing process capability for fuel cell open circuit voltage of fewer than 1,000 parts per million defects. This is an ongoing process improvement activity and similar improvements are targeted for stack build and FCM assembly.

The Group has completed the build of the second phase of the new test facilities which are now fully operational. This has substantially increased the Group's test capability across cell, stack, FCM and CHP testing and learning from the field trials has been incorporated in the testing protocols that enable extended testing of CHP products under representative in-home conditions. Additional investments have been made in increasing the Group's data mining capability to ensure that the results from testing can be more effectively analysed to inform the ongoing technical development.

Ceres has been awarded ISO9001:2008 certification for its Quality Management Systems. The certificate was awarded

In December 2010 the Group received CE Safety approval for its wall-mounted CHP product from Kiwa Gastec, the leading fuel cell and residential CHP certification body. Receipt of this approval was an important milestone allowing Ceres Power's CHP products to be installed and operated in occupied consumer homes.

In partnership with British Gas and using their in-home heating expertise, Ceres completed the installation of five CHP units in family homes across South East England directly replacing the existing conventional gas boilers. The field trial units delivered central heating, hot water and power to the homes and were controlled automatically, responding in real-time to the home's energy needs using a combination of the CHP unit's Fuel Cell Module and boiler. The purpose of this first wave of field trials was to gain valuable real-world experience and to identify issues ahead of deploying the next wave of field trial units in consumers' homes.

**"It is thanks to innovative research and product development by companies such as Ceres Power that we are leading the world with this sort of technology and which will help us realise our ambition to make the UK a leading high-tech, highly skilled economy."**

Mark Prisk MP, Minister of State for Business and Enterprise

following an audit conducted by the British Standards Institute and demonstrates the Group's commitment to developing quality systems to underpin volume manufacture and support the requirement of CE marking and FIT.

#### **Commercial opportunities**

The opportunity for Ceres' CHP product in international markets is substantial. The Group's compact wall-mounted product format and low-cost design can deliver substantial value to both households and energy companies in Europe, North America and Asia. Today, our primary focus remains on bringing the CHP product to market in the UK in partnership with British Gas and securing a significant share of the more than 1.5 million boilers that are sold every year in the UK.

In parallel, we are exploring new opportunities with partners in North America, Europe and Asia. In these markets the Group's compact low-cost product format can offer valuable benefits to consumers and energy companies when compared to conventional residential boiler

and water heater appliances. Ceres' technology, when deployed in large volumes, can also provide valuable real-time local balancing capacity to relieve grid strain and enable security of supply to be maintained in an environment where a greater proportion of wholesale power production is inflexible.

#### **Financial**

Commercial revenue for the year decreased by 12% to £0.7m (2010: £0.8m) driven largely by the delay in completing the CHP programme with British Gas and the resultant lower amortisation rate of the up-front milestone payments received. Deferred income, being the difference between milestone payments received and revenue recognised in the Consolidated Statement of Comprehensive Income, decreased to £2.5m (2010: £3.2m) reflecting the revenue recognised in the current year. Other operating income, being monies earned by the Group from government grant-funded programmes, fell to £0.4m (2010: £0.6m).

## Business Review

### Chief Executive Officer's Review

Continued

Operating costs increased by 22% to £17.7m (2010: £14.5m). Within operating costs, research and development costs increased by 30% to £12.9m (2010: £9.9m) and administrative expenses increased by 4% to £4.8m (2010: £4.6m). The increase in research and development has been driven by the increase in average monthly headcount from 70 to 105 persons, the costs of developing and procuring the components for the internal and external field trial testing and the increased production of fuel cells from the Horsham manufacturing facility.

Interest receivable was in line with the prior year at £0.5m (2010: £0.5m) and, following the redemption in December 2009 of the Group's holding of UK Government gilts, there was no fair value movement in the current year (2010: £0.1m loss). The Group recorded an income tax credit of £2.3m (2010: £1.1m) consisting of £1.5m estimated income tax recovery in respect of the current financial year and an additional £0.8m recovery in respect of the previous financial year.

The loss for the financial year attributable to shareholders increased by 18% to £13.8m (2010: £11.7m) due to the increased operating costs partly offset by higher financial income and increased R&D tax credits. The average number of shares in issue during the year was 86.2m (2010: 77.3m), reflecting the effect of the placing that occurred mid-way through the previous financial year. The loss per ordinary share rose to 16.04p from 15.16p in the previous financial year.

The Group's net cash used in operating activities increased by £3.4m to £13.4m (2010: £10m). This increase is attributable to the increased operating loss of £3.5m and an unfavourable working capital movement of £0.7m, partly offset by an increased income tax

receipt of £0.7m. During the year, the Group invested £2.3m (2010: £2.8m) to purchase additional fuel cell manufacturing equipment and to complete the expansion of the testing facilities and received a capital grant of £0.8m (2010: £0.3m). Total equity-free cash outflow for the year was £14.2m (2010: £12.3m).

As at the year end the Group held £26.7m (2010: £40.9m) in cash and cash equivalents and short-term investments. The Group's treasury policy to preserve capital by investing in low-risk, high-quality investments remains unchanged. Surplus funds are invested in short-term low-risk 'AAA'-rated money market funds and short-term deposits at banks with high credit ratings.

The Board anticipates that the Group will raise an initial tranche of funding during the next twelve months to continue the development, testing and trialing of the mains gas residential CHP product as set out in the Chairman's Statement.

#### microCHP opportunity

There can be no greater global challenge than the transition to a low-carbon economy that will involve major changes to the way we supply and use energy.

My examination of the market opportunity that Ceres can address has convinced me that the potential upside is enormous. By designing a product that retrofits in place of a conventional heating appliance, the Group can access an existing market of approximately 1.5 million units per annum in the UK alone, and more than 18 million units per annum globally.

The timing is right, the world needs cost-effective, cleaner, flexible power generation that can be retrofitted into the built environment, the Ceres CHP product is capable of delivering this.

#### Outlook

The Board and Senior Management team are focused on completing the work to enable the Group to achieve CHP product sales in H1 2014 and commence the development in 2012 of the next generation of the CHP product. To achieve this, the Group's priorities for the next twelve months are:

- > complete the validation and optimisation of the solutions to the remaining issues from the first phase of in-home field trials,
- > conduct extended internal testing of CHP products ahead of further in-home field trials,
- > commence the next phase of in-home field trials,
- > commence the development of the next generation of wall-mounted CHP product,
- > continue to work with our partner British Gas to refine the details of the UK product launch,
- > develop the next phase of strategic partner collaborations to further de-risk the commercialisation plan and
- > secure additional funding.

Ceres faces a number of challenges in the year ahead. I am confident that we can meet these challenges and successfully deliver both the commercialisation plan and significant value to shareholders.

**David Pummell**  
Chief Executive Officer  
11 October 2011

# Corporate Social Responsibility

Ceres Power is committed to building a high growth business while ensuring a safe environment for employees and minimising impact on the environment

We aim to understand and respond to the needs of shareholders, employees, customers, suppliers, the communities in which we work and the wider public

Our mission remains to make a major contribution towards the challenge of addressing climate change by providing cleaner, more efficient and decentralised energy products

## **Safety**

Ceres Power remains committed to achieving and maintaining the highest standards in health and safety practice. We work positively to create an open culture towards HSE and to engage all employees in helping maintain our excellent safety record. We invest in specialist roles and systems to support this process.

The Company is accredited with the British Safety Council as a training centre in health and safety. We

continue to commission regular reviews of our health and safety arrangements by independent external practice experts to ensure that we benefit from wider industry developments and secure continuous improvement in this area.

## **Employee development and retention**

The Group aims to recruit the best talent, acting as an equal opportunities employer at all times and ensuring that our staff remain safe from discrimination and harassment in the workplace. We invest in the training and development of our staff to build the required skills to succeed as a business. On average, we invested more than twice the national average per head on work-related training in 2010.

A third 'Save As You Earn' share scheme, open to all employees, was launched in 2011, enabling staff to share in the future success of the business and directly aligning the interests of employees and shareholders.

## **Environmental and community awareness**

Ceres complies with all relevant environmental laws and we implement best environmental practice in all of our activities. We seek to recycle in all areas – from office supplies to water consumption. We actively support cycling and car sharing and prioritise public over personal transport.

We seek to be a valued member of the community and consult locally on the possible impact of our operations, as well as informing the community on the type of employment opportunities we bring to the local area.

## **Ethical standards**

Ceres Power actively strives to achieve high ethical standards in all activities. We seek to ensure that our business partners apply similarly high standards, including our supply chain and customers. During the year we reviewed and updated our policy in this area and implemented a training programme to embed this with all staff.

## Directors and Senior Management

## Business Review

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### 1 Brian Count<sup>1</sup>

#### Non-Executive Chairman

Brian received a PhD in Physics after graduating in Mathematics from Cambridge University. He joined the UK's Central Electricity Generating Board and rose to become Director of Power Generation in National Power. He was appointed Chief Executive Officer of Innogy plc and subsequently Chief Executive of RWE Trading in Germany. He has also been a Non-Executive Director of Eskom, the South African electricity company. Brian is Non-Executive Chairman of Ceres Power, having joined the Company as a Non-Executive Director in March 2007. Brian sits on the Audit, Remuneration and the Nomination & Governance Committees.

### 2 David Pummell<sup>1, 2</sup>

#### Chief Executive Officer

David has a degree in Chemical Engineering from Salford University. He has previously held a number of roles at BP, including leading the European fuels and lubricants marketing business, directing the restructuring of BP's global refining and marketing businesses and setting up a new fuels and lubricants business in the Middle East. Most recently David was Chief Executive Officer of MAPS Technology Ltd, where he developed the company from an early-stage technology venture into a commercially successful business. He successfully oversaw the acquisition of MAPS Technology Ltd by the General Electric Company in early 2011.

### 3 Rex Vevers<sup>1, 2</sup>

#### Finance Director

Rex received an Economics degree from Newcastle University before joining Arthur Andersen where he qualified as a Chartered Accountant and Treasurer. He then pursued an industrial career where he held financial director roles in sectors spanning technology, volume manufacturing and finance, gaining significant international experience in corporate finance. Following positions at an industrial group and a global consumer products group, Rex joined Ceres Power in 2006 as the Group's Finance Director.

### 4. Phil Whalen<sup>1, 2</sup>

#### Technology Director

Phil received a PhD in Ceramic Science and Engineering from Rutgers University (USA) and has over twenty years experience leading global technology teams. Prior to joining Ceres Power, Phil was Corporate Director of Technology Strategy at Honeywell Inc and most recently was Chief Technology Officer of Invensys plc. Phil joined Ceres Power in July 2009 as Technology Director and was appointed onto the Ceres Power Holdings plc Board on 21 January 2010.

### 5 Bob Flint<sup>2</sup>

#### Commercial Director

Bob has a degree in Engineering from Cambridge University and an MBA from Imperial College London. He has spent over twenty years in the commercialisation of innovative technology through new products and services, venture creation and intellectual property licensing. Following a senior role at BAE Systems, Bob became Commercial Director of Ceres Power in 2005.

### 6 Jonathan Watkins<sup>2</sup>

#### Operations Director

Jonathan is a Chartered Engineer with an honours degree in Materials Science and Technology from Birmingham University and a post-graduate diploma in Manufacturing Engineering and Management from Cambridge University. Jonathan has experience of running multi-site manufacturing businesses with T&N plc and more recently with the European automation and fastening arm of Textron Inc – a global tier-one automotive supplier. Jonathan joined Ceres Power in November 2008 and in January 2009 became Operations Director.

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**7 Sir David Brown<sup>1</sup>****Non-Executive Director**

David is a Fellow of the Royal Academy of Engineering and in 2001 was knighted for services to British industry. He followed a career first with Plessey then with STC, ICL and Nortel, and then became Chairman of Motorola Limited from 1997 until mid-2008. David is a Director of two other publicly quoted companies and joined Ceres Power in February 2008 as Non-Executive Director, becoming the Group's Senior Independent Director in 2009. He sits on the Audit, Remuneration, Nomination & Governance and the Technical & Operational Risk Committees.

**8 Alan Wood<sup>1</sup>****Non-Executive Director**

Alan holds an honours degree in Mechanical Engineering from Manchester University and an MBA from Harvard University. Following an early career in manufacturing industries spanning food products, construction and electrical engineering, Alan became Non-Executive Chairman of Siemens Holdings plc and is also a Director of a number of other publicly quoted companies. He joined Ceres Power in February 2008 as a Non-Executive Director and sits on the Remuneration, Nomination & Governance and the Technical & Operational Risk Committees.

**9 John Nicholas<sup>1</sup>****Non-Executive Director**

John is a Fellow of the Association of Chartered Certified Accountants and holds an MBA from Kingston University. Much of his early career was spent in technology-focused, international manufacturing and service companies. John became Group Finance Director of Kidde plc on its demerger from Williams Holdings and was also Group Finance Director at Tate & Lyle plc. John is a Director of a number of other publicly quoted companies and joined Ceres Power in February 2009 as a Non-Executive Director. He sits on the Audit, Remuneration and Nomination & Governance Committees.

<sup>1</sup> Director of Ceres Power Holdings plc

<sup>2</sup> Director of Ceres Power Limited

## Corporate Governance Report

## Corporate Governance

### Principles of corporate governance

The Board of Directors recognises the importance of good corporate governance to enhance and protect shareholder value. As the Company's shares are registered on the Alternative Investment Market ('AIM') of the London Stock Exchange, the Company is not required to report against the UK Corporate Governance Code published in May 2010 (the 'Code'). However, the Board supports the principles contained in the Code and is committed to applying them, where they are appropriate, given the Company's size. The following describes how these principles have been applied.

### The Board of Directors

The Board comprises the Non-Executive Chairman, the Chief Executive Officer, the Finance Director, the Technology Director, the Senior Independent Non-Executive Director and two other Non-Executive Directors. On 13 June 2011, Dr Peter Bance left the Board as Chief Executive Officer and Dr Brian Count assumed the role of Executive Chairman. On 17 August 2011, David Pummell was appointed as Chief Executive Officer. He took up the post on 5 September 2011. On the same date Dr Brian Count reassumed the role of Non-Executive Chairman. Dr Brian Count was not independent during the short period that he was Executive Chairman. The Board considers that the Non-Executive Directors are independent in character and judgement and meet the criteria for independence set out in the Code.

The Company's articles of association require that all Directors are subject to election by shareholders at the first Annual General Meeting ('AGM') following their initial appointment, and at each AGM one-third of the Directors retire by rotation and offer themselves for re-election.

David Pummell offers himself for election at the AGM following his appointment. Sir David Brown and Rex Vevers retire by rotation and offer themselves for re-election.

The Company maintains directors' and officers' liability insurance cover, the level of which is reviewed annually.

### Board Committees

The terms of reference of the Board Committees are posted on the Company's website and are available on request from the Company Secretary.

### Audit Committee

The Audit Committee currently comprises Dr Brian Count and Sir David Brown under the Chairmanship of John Nicholas. Meetings of the Committee are attended, at the invitation of the Committee, by the external auditors and the Finance Director. The Committee meets with the external auditors on a regular basis without the Executive Directors being present.

The Committee is authorised to seek any information it requires from any employee of the Group in order to perform its duties, and obtain any outside legal or other independent professional advice it requires at the Company's expense.

The Audit Committee met three times during the year. During these meetings the Audit Committee considered, amongst other items, the following:

- the integrity of the financial statements and other formal announcements relating to the Group's financial performance, the going concern status of the Group and judgements that are contained within the financial statements,
- the Group's internal control and risk management policies and systems, and their effectiveness,
- the Group's whistle-blowing procedures to ensure that employees are able to raise concerns, in confidence, about possible wrong doing in financial reporting and other matters,
- the requirements for an internal audit function. The Audit Committee is satisfied that the Group does not currently require an internal audit function,
- the relationship with the external auditor, in particular satisfying itself as to the independence and effectiveness of the external auditor, and
- the policy on the engagement of the external auditors to supply non-audit services.

### Remuneration Committee

The members of the Committee are Dr Brian Count, Alan Wood and John Nicholas under the chairmanship of Sir David Brown. The Committee met five times during the year.

Further details on the roles and responsibilities of the Remuneration Committee and the Company's policy on Directors' remuneration are included within the Remuneration Report, set out on pages 16 to 20.

### Nomination & Governance Committee

The members of this Committee are Sir David Brown, Alan Wood and John Nicholas, under the Chairmanship of Dr Brian Count. The Committee considers the composition of the Board and is responsible for reviewing the composition and structure of the Board and for identifying and recommending candidates for Executive and Non-Executive Director positions.

### Technical & Operational Risk Committee

The members of this Committee are Sir David Brown, Dr Phil Whalen and Jonathan Watkins, under the Chairmanship of Alan Wood. The Committee is responsible for monitoring key technical and operational risks and the development and implementation of strategies to manage and mitigate these risks.

**Communications with shareholders**

The Board is accountable to the Company's shareholders and as such it is important for the Board to maintain effective communications with shareholders. The Company maintains an active dialogue with institutional shareholders through regular briefing meetings and formal presentations by the Executive Directors following the interim and preliminary financial results. During the year, the views of major shareholders are communicated to the Board through briefings by the Company's brokers and face-to-face meetings with the Chairman. Press releases are issued throughout the year and the Company maintains a website ([www.cerespower.com](http://www.cerespower.com)) on which press releases, corporate presentations and the Annual Report are available to view.

The AGM provides an opportunity for communication with all shareholders and the Board encourages the shareholders to attend and welcomes their participation. The Directors attend the AGM and are available to answer questions.

**Internal controls**

The Directors acknowledge their responsibility for establishing and maintaining the Group's systems of internal control. These are designed to safeguard the assets of the Group and to ensure the reliability of financial information for both internal and external use.

The Group prepares detailed budgets and cash flow projections, which are approved annually by the Board and updated regularly throughout the year. Detailed management accounts and working capital cash flow projections are prepared on a monthly basis and compared to budgets and projections to identify any significant variances. The Board reviews, identifies, evaluates and manages the significant risks that face the Group.

Any system of internal control can only provide reasonable, and not absolute, assurance that material financial irregularities will be detected or that risk of failure to achieve business objectives is eliminated. The Directors, having reviewed the effectiveness of the system of internal financial, operational and compliance controls and risk management, consider that the systems of internal control operated effectively throughout the financial year and up to the date that the financial statements were signed.

**Conflicts of interest**

The Group has in place procedures for the disclosure and review of any conflicts or potential conflicts of interest which the Directors may have and for the authorisation of such conflicts by the Board. During the year there were no such conflicts of interest.

## Remuneration Report

The Board of Directors presents the Company's Remuneration Report for the year ended 30 June 2011. As the Company's shares are registered on the Alternative Investment Market ('AIM') of the London Stock Exchange, the Company is not required to report in accordance with the remuneration disclosure requirements of the Companies Act 2006 and relevant regulations. This report, while not complying fully with these requirements, has been presented to disclose the key aspects of Directors' remuneration and the Board hopes that this report will provide shareholders with a better understanding of the rationale behind the current remuneration arrangements for senior management and the link between the performance of the Group and the rewards for executives.

All sections of the Remuneration Report, other than those specifically marked as audited, are unaudited.

### Composition and role of the Remuneration Committee

The Remuneration Committee comprises the Non-Executive Directors and is chaired by Sir David Brown, Senior Independent Director. The Committee met five times during the year. The Chief Executive Officer is invited to attend meetings to assist the Committee on matters concerning remuneration of other senior executives within the Group, however he is not present during the part of the meetings where his own remuneration is discussed.

The Committee is responsible for determining, on behalf of the Board, an appropriate remuneration policy for the Executive Directors and for designing a remuneration framework for them that is consistent with that policy. The Committee also monitors remuneration practice amongst other members of the senior management team, determines the Chairman's fee level and oversees the compensation philosophy of Ceres Power generally.

At its meetings during the year, the Committee considered, amongst other matters, the following:

- the 2010 Remuneration Report,
- the level of achievement of the final phase of the Combined Heat and Power ('CHP') Project Bonus Plan targets,
- the design of a new incentive scheme for the executive team members and other senior managers,
- setting performance targets in respect of the 2011/12 Bonus Plan,
- implementation of a third Company-wide Sharesave scheme,
- levels of base salary for Executive Directors,
- terms of employment for all members of the senior management team,
- proposed terms of appointment of members of the senior management team,
- the annual review of rewards and benefits available to all employees in the Group, and
- the termination arrangements for the CEO, Dr Peter Bance, who resigned on 13 June 2011.

During the year the Committee has been advised by independent remuneration consultants Hewitt New Bridge Street ('HNBS'). Neither HNBS nor any other part of Aon Hewitt provided any other services to the Group during the year.

### Remuneration policy for Executive Directors

The Committee's policy is that Executive Directors' remuneration packages should:

- provide the Directors with the opportunity to receive a share in the future growth and value of the Group that is regarded as fair by other employees and by shareholders,
- provide appropriate alignment between the Group's strategic and operational goals for which the Directors have collective responsibility, shareholder returns and executive reward,
- be, as far as possible, simple to understand and administer,
- be determined taking into account external market benchmarks, so that the total value of remuneration packages (calculated on a 'target' basis) should be broadly competitive with mid-market practice compared to listed companies of a similar size within similar sectors. This should allow the Group to attract and retain key individuals critical to the future success of the business,
- include below market levels of fixed pay (salary and benefits) in return for above market levels of performance-related pay whilst the Group continues its development towards commercialisation. The Committee envisages that a more standard pay structure, with market levels of fixed and performance-related pay, will be introduced once the Group has reached a commercial stage,
- be appropriate given pay levels within the Group more generally, and
- be structured so as to comply with key corporate governance best practice guidelines.

### Remuneration structure for Executive Directors

#### Overview

The Committee continues to believe that at this stage of the Group's development the remuneration structure for Executive Directors should be weighted more towards performance-related pay than would be the market 'norm' for an 'established' company. The Committee envisages that a more standard pay structure, with market levels of fixed and performance-related pay, will be introduced once the Group has reached a commercial stage.

#### Base salary

Executive Directors' base salaries are reviewed annually although they have been frozen (other than for new appointments) since 1 July 2008. The Committee decided to award an increase effective on 1 July 2011 of 5% to Rex Vevers and Dr Philip Whalen. The agreed salaries for 2011/12 are: Rex Vevers £170,350 (2010/11 £162,225) and Dr Philip Whalen £170,350 (2010/11 £162,225).

Dr Peter Bance, Chief Executive Officer, stepped down from the Board and left the Company on 13 June 2011. He received his contractual entitlement of one year's salary (£196,833) on termination plus a further £88,550 compensation in respect of his UK statutory employment rights. The Remuneration Committee has treated Dr Bance as a 'good leaver' under the Group's Option scheme rules. He therefore retains all of his share options, except those options where the exercise period commences more than twelve months after the date of resignation.

David Pummell was appointed Chief Executive Officer on 17 August 2011 and took up the post on 5 September 2011. Under the terms of his service contract, he will receive a base salary of £250,000 per annum, terminable by the Group on not more than twelve months' notice, and he will be eligible to participate in the Group's 2011/12 incentive plans.

#### Benefits

In line with all other employees, Executive Directors receive a pension contribution from the Group worth 8% of salary (with Executive Directors contributing at least 3% of salary) plus employer's National Insurance saved on employee pension contributions from the Group. They also receive life assurance of four times salary.

#### Sharesave scheme

During the year the Committee implemented a third HMRC-approved Sharesave scheme. The Executive Directors are eligible to participate in this Scheme, which is open to all eligible employees on the same basis, providing a long-term savings and investment opportunity.

#### Performance-related pay

##### 2010/11 Incentive arrangements

Details of the two incentive arrangements that operated in respect of 2010/11 and any awards made thereunder are outlined below.

##### One-off grant of share options

Dr Peter Bance, Rex Vevers and other senior executives were granted a one-off award of share options under the Company's existing 2004 Employees' Share Option Scheme in 2008. Dr Phil Whalen was granted a one-off award of share options on joining the Company in 2009.

The share options were granted with an exercise price of £2 per share, being the higher of the average market price over the twenty trading days ending on 9 December 2008 (being £0.92) and £2. Exercise of the options is subject to the prior achievement of an absolute share price target and normally is dependent on continued employment until the initial exercise point.

The options granted in 2008 and 2009 to the Executive Directors and other senior executives can only be exercised if the following share price targets are achieved over twenty consecutive trading days at some point in the period between the second and tenth anniversaries of the grant.

|           | Percentage<br>of options<br>exercisable | Share<br>price<br>target | Exercise<br>period<br>(post grant) |
|-----------|-----------------------------------------|--------------------------|------------------------------------|
| Tranche 1 | 25%                                     | £4                       | 2–10 years                         |
| Tranche 2 | 37.5%                                   | £5                       | 3–10 years                         |
| Tranche 3 | 37.5%                                   | £6                       | 4–10 years                         |

#### CHP Project Bonus Plan

The CHP Project Bonus Plan is the only bonus scheme for Executive Directors that operated during the year.

Under this plan, Executive Directors and selected other senior executives and staff are eligible to receive a bonus at the completion of relevant phases of the CHP Project over the period 2008/09–2010/11. The maximum potential bonus award at the end of each phase is 100% of annual salary for the Chief Executive Officer and for all other eligible participants no more than 75% of their base salary. All awards for the successful completion of each phase made under this plan are payable in two instalments, 50% of any award is payable immediately in cash and the remaining 50% as a deferred award in the form of nominal value share options which vest to the individual no earlier than 30 June 2012, subject normally to continued employment within the Group.

The amount of any award granted under this plan is subject to the Committee's assessment of the level and quality of delivery of each of the phases of the CHP Project at the completion of each phase of the project (known as 'milestone targets').

The Committee has reviewed achievement of the 2010/11 milestone targets including technology, manufacturing, commercial and financial metrics and concluded that the Company has not met the key milestones. Accordingly, the Committee has determined that the Executive Directors should be awarded a zero bonus award for the period. Notwithstanding the failure to achieve the key milestones, the Group has achieved a number of important targets that underpin its progress. The Committee has therefore approved bonus awards up to 18% of salary to participating senior managers and staff and the Committee would like to express its thanks for the substantial contribution and effort that these employees have made during a challenging year. This bonus was approved in July 2011, at which time the options were granted.

## Corporate Governance

### Remuneration Report

Continued

#### 2011/12 Incentive arrangements

During the year the Committee, assisted by HNBS, has formulated new incentive arrangements that will operate for the 2011/12 financial year. The Committee has decided to move towards the approach associated with a more traditional listed company. The new arrangements comprise a combination of i) an annual bonus (where performance is measured over one year), and ii) annual grant of long-term share awards (where performance is typically measured over three years). The incentive arrangements provide executives with a clear 'line-of-sight' between reward and performance.

Details of the new incentive arrangements in place for the 2011/12 financial year are as follows:

#### Annual bonus

This scheme succeeds the CHP Project Bonus Plan and is the only bonus scheme for Executive Directors that will operate in 2011/12.

Under the bonus scheme, Executive Directors and selected other senior executives and staff are eligible to receive a bonus payable wholly in cash based upon the successful achievement of key milestones that underpin the Company's progress towards the successful launch of a residential CHP product. The maximum potential annual bonus award is 100% of base salary for the Chief Executive Officer, Finance Director and Technology Director and for all other eligible participants no more than 75% of their base salary.

#### Share options

In respect of long-term share awards, the Committee concluded that:

- a policy of granting share options remained appropriate for 2011/12,
- options should have a market value exercise price,
- the adoption of an annual grant policy was appropriate (rather than another large one-off award as was granted in 2008/09 and 2009/10),
- options should be subject to challenging absolute share price targets, and
- there should be no facility to retest the share price targets beyond the third anniversary of grant.

Accordingly, the Committee intends to grant Executive Directors and certain senior managers an award of share options following the publication of the Group's 2010/11 Annual Report, which is anticipated to be by the end of October 2011.

The share options will be granted at an exercise price to be determined based on the mid-market closing share price on the second trading day following the publication of the 2010/11 Annual Report on the Group's website. The options granted will vest on the third anniversary subject to the following share price targets having been achieved over twenty consecutive trading days within three years from the date of grant:

| Share price             | Percentage of options vesting        |
|-------------------------|--------------------------------------|
| Less than £1.50         | Zero                                 |
| £1.50                   | 50%                                  |
| At least £2.50          | 100%                                 |
| Between £1.50 and £2.50 | 50% to 100% on a straight-line basis |

The share options will lapse on the third anniversary of the date of grant unless the share price performance targets have been achieved. To the extent that the targets are satisfied, the options will be exercisable until the tenth anniversary of the grant.

Full details of the options awarded to Executive Directors will be published via the Regulatory News Service of the London Stock Exchange.

#### Share ownership guideline

Executive Directors are required to retain at least half of any shares arising from the exercise of any options under the one-off award and any future option grant (after selling sufficient shares to pay the exercise price and to fund any tax due on the options) until they have a holding of Company shares worth at least 100% of their base salary (200% for the Chief Executive Officer). Compliance with this guideline is reviewed annually by the Remuneration Committee.

#### Service contracts

Each Executive Director has a service contract with the Group which contains details regarding remuneration, restrictions and disciplinary matters. Executive Directors are appointed on contracts terminable by the Group on not more than twelve months' notice.

### Non-Executive Directors

The fees of the Chairman are determined by the Committee and the fees of the Non-Executive Directors are determined by the Board following a recommendation from the Chairman after consulting with the Chief Executive Officer. The Chairman and the Non-Executive Directors are not involved in any discussions or decisions about their own remuneration.

The annual fee levels as at 30 June 2011 (unchanged since 30 June 2009) are as follows

|                               | 2011<br>£ |
|-------------------------------|-----------|
| Chairman                      | 100,000   |
| Senior Non-Executive Director | 45,000    |
| Other Non-Executive Directors | 40,000    |

Chairs of Board Committees, other than the Chairman, earn an additional £5,000 per annum per Committee, and each of Sir David Brown, Alan Wood and John Nicholas chaired one Committee during the year.

Non-Executive Directors are not eligible to participate in any of the Group's incentive schemes.

Dr Brian Count received no additional fee for the period during which he served as Executive Chairman, between the resignation of Dr Peter Bance on 13 June 2011 and the date David Pummell took up his post on 5 September 2011.

### Directors' emoluments for the year ended 30 June 2011 (audited)

|                             | 2010/11         |                           |                                     |                             |            |
|-----------------------------|-----------------|---------------------------|-------------------------------------|-----------------------------|------------|
|                             | Salary/fee<br>£ | Pension <sup>1</sup><br>£ | Other<br>benefits <sup>2</sup><br>£ | Termination<br>payment<br>£ | Total<br>£ |
| <b>Executive</b>            |                 |                           |                                     |                             |            |
| Dr Peter Bance <sup>3</sup> | 187,652         | 17,017                    | –                                   | 285,383                     | 490,052    |
| Rex Vevers                  | 162,225         | 14,135                    | –                                   | –                           | 176,360    |
| Dr Phil Whalen              | 162,225         | 13,739                    | 41,703                              | –                           | 217,667    |
| <b>Non-Executive</b>        |                 |                           |                                     |                             |            |
| Dr Brian Count <sup>4</sup> | 100,000         | –                         | –                                   | –                           | 100,000    |
| Sir David Brown             | 50,000          | –                         | –                                   | –                           | 50,000     |
| John Nicholas               | 45,000          | –                         | –                                   | –                           | 45,000     |
| Alan Wood                   | 45,000          | –                         | –                                   | –                           | 45,000     |
|                             | 752,102         | 44,891                    | 41,703                              | 285,383                     | 1,124,079  |

### Directors' emoluments for the year ended 30 June 2010 (audited)

|                             | 2009/10         |                           |            |
|-----------------------------|-----------------|---------------------------|------------|
|                             | Salary/fee<br>£ | Pension <sup>1</sup><br>£ | Total<br>£ |
| <b>Executive</b>            |                 |                           |            |
| Dr Peter Bance              | 196,833         | 17,284                    | 214,117    |
| Rex Vevers                  | 162,225         | 14,861                    | 177,086    |
| Dr Phil Whalen <sup>5</sup> | 68,808          | 5,210                     | 74,018     |
| <b>Non-Executive</b>        |                 |                           |            |
| Dr Brian Count <sup>4</sup> | 100,000         | –                         | 100,000    |
| Sir David Brown             | 50,000          | –                         | 50,000     |
| John Nicholas               | 45,000          | –                         | 45,000     |
| Alan Wood                   | 45,000          | –                         | 45,000     |
|                             | 667,866         | 37,355                    | 705,221    |

<sup>1</sup> Pension contribution is based on 8% of gross salary and employer's National Insurance saved on employee pension contributions.

<sup>2</sup> Other benefits comprise relocation and other costs borne by the Company.

<sup>3</sup> Dr Peter Bance resigned on 13 June 2011.

<sup>4</sup> Fees totalling £75,000 (2010: £100,000) were paid to Count on B Limited, a company of which Dr Brian Count is a Director.

<sup>5</sup> Dr Phil Whalen was appointed to the Board of Directors on 21 January 2010.

Corporate  
GovernanceRemuneration Report  
Continued

## Directors' interests in share options (audited)

|                                   | At 1 July<br>2010<br>number | Granted<br>number | Lapsed<br>number | At 30 June<br>2011<br>number <sup>5</sup> | Exercise<br>price | Exercise period               |
|-----------------------------------|-----------------------------|-------------------|------------------|-------------------------------------------|-------------------|-------------------------------|
| Dr Peter Bance                    |                             |                   |                  |                                           |                   |                               |
| Options (approved)                | 184,780                     | –                 | –                | <b>184,780</b>                            | £0.30             | April 2003–April 2013         |
| Options (unapproved)              | 1,182,620                   | –                 | –                | <b>1,182,620</b>                          | £0.30             | April 2003–April 2013         |
| Options (unapproved) <sup>1</sup> | 500,000                     | –                 | –                | <b>500,000</b>                            | £0.30             | August 2003–August 2013       |
| Options (unapproved)              | 200,000                     | –                 | –                | <b>200,000</b>                            | £0.60             | April 2004–April 2014         |
| Options (unapproved)              | 200,000                     | –                 | –                | <b>200,000</b>                            | £2.815            | March 2006–March 2016         |
| Options (unapproved) <sup>1</sup> | 212,500                     | –                 | –                | <b>212,500</b>                            | £2.00             | December 2010–December 2018   |
| Options (unapproved) <sup>2</sup> | 318,750                     | –                 | –                | <b>318,750</b>                            | £2.00             | December 2011–December 2018   |
| Options (unapproved) <sup>3</sup> | 318,750                     | –                 | (318,750)        | –                                         | £2.00             | December 2012–December 2018   |
| Sharesave options (approved)      | 5,648                       | –                 | –                | <b>5,648</b>                              | £0.81             | July 2012–December 2012       |
| Options (unapproved) <sup>4</sup> | 38,048                      | –                 | –                | <b>38,048</b>                             | £0.05             | July 2012–June 2019           |
| Sharesave options (approved)      | 4,051                       | –                 | (4,051)          | –                                         | £1.12             | July 2013–December 2013       |
| Sharesave options (approved)      | –                           | 11,281            | –                | <b>11,281</b>                             | £0.40             | July 2014–December 2014       |
|                                   | <b>3,165,147</b>            | <b>11,281</b>     | <b>(322,801)</b> | <b>2,853,627</b>                          |                   |                               |
| Rex Ververs                       |                             |                   |                  |                                           |                   |                               |
| Options (approved)                | 46,510                      | –                 | –                | <b>46,510</b>                             | £2.15             | September 2006–September 2016 |
| Options (unapproved)              | 228,490                     | –                 | –                | <b>228,490</b>                            | £2.15             | September 2006–September 2016 |
| Options (unapproved) <sup>1</sup> | 159,375                     | –                 | –                | <b>159,375</b>                            | £2.00             | December 2010–December 2018   |
| Options (unapproved) <sup>2</sup> | 239,063                     | –                 | –                | <b>239,063</b>                            | £2.00             | December 2011–December 2018   |
| Options (unapproved) <sup>3</sup> | 239,062                     | –                 | –                | <b>239,062</b>                            | £2.00             | December 2012–December 2018   |
| Sharesave options (approved)      | 5,648                       | –                 | –                | <b>5,648</b>                              | £0.81             | July 2012–December 2012       |
| Options (unapproved) <sup>4</sup> | 23,518                      | –                 | –                | <b>23,518</b>                             | £0.05             | July 2012–June 2019           |
| Sharesave options (approved)      | 4,051                       | –                 | (4,051)          | –                                         | £1.12             | July 2013–December 2013       |
| Sharesave options (approved)      | –                           | 11,281            | –                | <b>11,281</b>                             | £0.40             | July 2014–December 2014       |
|                                   | <b>945,717</b>              | <b>11,281</b>     | <b>(4,051)</b>   | <b>952,947</b>                            |                   |                               |
| Dr Phil Whalen                    |                             |                   |                  |                                           |                   |                               |
| Options (unapproved) <sup>1</sup> | 53,125                      | –                 | –                | <b>53,125</b>                             | £2.00             | September 2011–August 2019    |
| Options (unapproved) <sup>2</sup> | 79,688                      | –                 | –                | <b>79,688</b>                             | £2.00             | September 2012–August 2019    |
| Options (unapproved) <sup>3</sup> | 79,687                      | –                 | –                | <b>79,687</b>                             | £2.00             | September 2013–August 2019    |
| Sharesave options (approved)      | –                           | 11,281            | –                | <b>11,281</b>                             | £0.40             | July 2014–December 2014       |
|                                   | <b>212,500</b>              | <b>11,281</b>     | <b>–</b>         | <b>223,781</b>                            |                   |                               |

1 One off options, exercisable if the share price is greater than or equal to £4 over twenty consecutive trading days at some point in the exercise period

2 One off options exercisable if the share price is greater than or equal to £5 over twenty consecutive trading days at some point in the exercise period

3 One off options exercisable if the share price is greater than or equal to £6 over twenty consecutive trading days at some point in the exercise period

4 CHP Project Bonus Plan deferred share options

5 Or date of resignation, if earlier

All options outlined above are fully exercisable at the Director's discretion during the relevant exercise period

During 2010/11, the Group's share price varied between 24 00p and 96 50p and was 36 00p on 30 June 2011

## Directors' interests in shares (unaudited)

The Directors held the following interests in the shares of the Company

| Name            | Type                          | At 1 July<br>2010 | At 30 June<br>2011 |
|-----------------|-------------------------------|-------------------|--------------------|
| Dr Brian Count  | Ordinary shares of £0.05 each | 257,850           | <b>357,850</b>     |
| Rex Ververs     | Ordinary shares of £0.05 each | 80,000            | <b>80,000</b>      |
| Dr Phil Whalen  | Ordinary shares of £0.05 each | –                 | <b>15,841</b>      |
| Sir David Brown | Ordinary shares of £0.05 each | 20,000            | <b>20,000</b>      |
| Alan Wood       | Ordinary shares of £0.05 each | 50,000            | <b>50,000</b>      |
| John Nicholas   | Ordinary shares of £0.05 each | 100,000           | <b>100,000</b>     |
| Dr Peter Bance  | Ordinary shares of £0.05 each | –                 | <b>20,000</b>      |

No Directors have purchased shares in the Company since 30 June 2011

## Sir David Brown

Remuneration Committee Chairman

11 October 2011

## Directors' Report

for the year ended 30 June 2011

The Directors present their report and the audited financial statements for the year ended 30 June 2011

### Principal activity

The principal activity of the Group throughout the year remained the development and commercial exploitation of microgeneration products based on the Group's solid oxide fuel cell technology

### Review of business and future developments

Significant developments and operating activities of the Group, as well as the future strategy, business environment and prospects for the Group are discussed in detail in the Chairman's Statement and the Chief Executive Officer's Review on pages 2 to 10

In addition to the Group's priorities as set out in the Chief Executive Officer's Review, the Group considers its Key Performance Indicators ('KPIs') to be revenue and net cash and financial assets measured against predetermined targets. The Directors recognise the progress made in delivering the Group's key priorities during the year, and the challenges faced in the achievement of the KPIs, when measured against their targets, as noted in the Chairman's Statement and the Chief Executive Officer's Review

### Results and dividends

The loss for the financial year was £13,821,000 (2010 £11,723,000). The cash used in operations during the year was £14,824,000 (2010 £10,820,000). At 30 June 2011 the Group had net cash and short-term investments of £26,687,000 (2010 £40,900,000)

The Directors do not recommend the payment of a dividend (2010 £nil)

### Research and development

During the year, the Group incurred expenditure of £12,869,000 (2010 £9,907,000) on research and development, all of which was written off to the Consolidated Statement of Comprehensive Income. The Chief Executive Officer's Review reports on progress during the year

### Charitable and political contributions

The Group made no charitable or political contributions during the year (2010 £nil)

### Principal risks and uncertainties

In addition to financial risk management which is detailed in note 14 to the financial statements, there are a number of risks and uncertainties which could have a material impact on the execution of the Group's strategy. Risks are formally reviewed by the Board and appropriate processes and controls put in place to monitor and mitigate them. Key business risks are set out as follows

### Future funding risk

The future funding needs of the business are discussed on pages 2 and 10 of the Chairman's Statement and Chief Executive Officer's Review respectively

### Technology risk

As described in the Chief Executive Officer's Review, the Group continues to make progress in the development of its fuel cell residential Combined Heat and Power ('CHP') product. However, uncertainty still exists regarding the successful development and application of the Company's fuel cell technology to CHP and other potential products

### Competitive and market risk

The Group continues to target both existing and new markets in which to sell its products. Future revenues are dependent on the development of such markets and the impact on these markets of alternative products from competitors

### Global economic and credit market risk

The credit market conditions continue to provide an increased risk of a counterparty exposure should any counterparty default on its contractual obligations. Whilst there have been improvements in the global economy during 2010 and 2011, there is continued uncertainty around the restructuring of European sovereign debt, which could adversely impact the global economy. The Group is at risk to increased cost and delays through exposure to the default of suppliers if economic conditions do not continue to improve. The Directors continue to closely monitor these risks

### Intellectual Property protection risk

The Group continues to invest in the expansion and protection of its portfolio of intellectual property. The Group's competitive advantage is at risk to unauthorised parties using the Group's technology in their own products. Internal procedures and controls are therefore in place to capture all Intellectual Property ('IP') and then to prevent or control disclosure to third parties and partners. There is always a degree of uncertainty over the ability to register certain IP rights. IP insurance provides additional protection for agreement, pursuit and defence of IP terms and rights

### Growth management risk

The Group has grown significantly in the past years and anticipates further growth over the coming years. Investment in operational, manufacturing, managerial resources and systems and controls continues in order to meet the expected growth. There is a risk that growth will be constrained by insufficient resources

### Key personnel dependence risk

As disclosed in the Remuneration Report section of this Annual Report and in the notes to the Group financial statements, the Directors have put in place incentive schemes for key personnel. These support the existing competitive remuneration packages and restrictive employment covenants already in place. These are aimed at reducing the risk of disruption to operations and damage to the business due to key personnel leaving the business

## Corporate Governance

### Directors' Report

for the year ended 30 June 2011

#### Directors

The Directors of the Company, who served during the year and up to the date of signing the financial statements, are as follows

Dr Brian Count (Non-Executive Chairman) – appointed Executive Chairman on 13 June 2011, reappointed Non-Executive Chairman on 5 September 2011  
David Pummell (Chief Executive Officer) – appointed 17 August 2011, took up position 5 September 2011  
Dr Peter Bance (Chief Executive Officer) – resigned 13 June 2011  
Rex Vevers (Finance Director)  
Dr Phil Whalen (Technology Director)  
Sir David Brown (Non-Executive Director)  
Alan Wood (Non-Executive Director)  
John Nicholas (Non-Executive Director)

#### Substantial shareholders

The Company has been notified of the following holdings of 3% or more of the 86,177,614 ordinary shares of 5p each of the Company on 7 October 2011

| Investor                                             | Number of ordinary shares | Percentage |
|------------------------------------------------------|---------------------------|------------|
| Oppenheimer Funds Inc                                | 11,291,902                | 13.10%     |
| GB Gas Holdings Limited                              | 8,562,488                 | 9.94%      |
| Sarasin & Partners LLP                               | 5,011,274                 | 5.82%      |
| Imperial College of Science, Technology and Medicine | 4,459,229                 | 5.17%      |
| GLG Partners LP                                      | 4,305,214                 | 5.00%      |
| I G Investment Management Ltd                        | 3,466,730                 | 4.02%      |
| FIL ('Fidelity Investments Limited')                 | 3,321,326                 | 3.85%      |
| FMR Corp ('Fidelity Investments')                    | 2,766,362                 | 3.21%      |

#### Policy and practice on payment of creditors

It is the Group's policy, in respect of all suppliers, to agree payment terms in advance of the supply of goods and services and to adhere to those payment terms. Trade creditors of the Group at the year end as a proportion of amounts invoiced by suppliers during the year represent 68 days (2010: 51 days). Trade creditors of the Company at the year end as a proportion of amounts invoiced by suppliers during the year represent 26 days (2010: 24 days).

#### Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union, and the parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law).

Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the 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 IFRSs as adopted by the European Union and applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Group and parent Company financial statements respectively, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They 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.

#### Going concern

The Group's likely future funding needs are discussed on pages 2 and 10 of the Chairman's Statement and Chief Executive Officer's Review respectively. After having made appropriate enquiries, the Directors have a reasonable expectation that the Group and Company have adequate resources to fund operations for the foreseeable future and anticipate securing additional funding to progress their established strategy. Accordingly, they continue to adopt the going concern basis in preparing these financial statements.

#### Directors' statement on disclosure of information to auditors

So far as each Director is aware, there is no relevant audit information of which the Company's auditors are unaware. Each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

#### 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.

By order of the Board

**Brian Count**  
Chairman  
11 October 2011

## Independent Auditors' Report to the Members of Ceres Power Holdings plc

We have audited the Group financial statements of Ceres Power Holdings plc for the year ended 30 June 2011 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Consolidated Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union.

### Respective responsibilities of Directors and auditors

As explained more fully in the Statement of Directors' responsibilities set out on page 22, the Directors are responsible for the preparation of the Group 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 Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

### Scope of the audit of the financial statements

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 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. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the Group financial statements

- give a true and fair view of the state of the Group's affairs as at 30 June 2011 and of its loss and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

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

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

### Other matter

We have reported separately on the parent Company financial statements of Ceres Power Holdings plc for the year ended 30 June 2011 and on the information in the Directors' Remuneration Report that is described as having been audited.

### Rosemary Shapland (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Gatwick  
11 October 2011

**Financial  
Statements**
**Consolidated Statement of Comprehensive Income**  
 for the year ended 30 June 2011

|                                                                    | Note | 2011<br>£'000   | 2010<br>£'000 |
|--------------------------------------------------------------------|------|-----------------|---------------|
| <b>Revenue</b>                                                     | 2    | <b>692</b>      | 786           |
| Operating costs                                                    | 3    | (17,702)        | (14,543)      |
| Other operating income                                             | 3    | 352             | 570           |
| <b>Operating loss</b>                                              |      | <b>(16,658)</b> | (13,187)      |
| Fair value loss on gilts                                           | 4    | -               | (119)         |
| Interest receivable                                                | 4    | 503             | 490           |
| <b>Loss before income tax</b>                                      | 3    | <b>(16,155)</b> | (12,816)      |
| Income tax credit                                                  | 7    | 2,334           | 1,093         |
| <b>Loss for the financial year and total comprehensive loss</b>    |      | <b>(13,821)</b> | (11,723)      |
| <b>Loss per £0.05 ordinary share expressed in pence per share*</b> |      |                 |               |
| - basic and diluted                                                | 8    | (16.04)p        | (15.16)p      |

The notes on pages 28 to 42 are an integral part of these consolidated financial statements

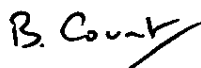
## Consolidated Balance Sheet

as at 30 June 2011

|                                              | Note | 2011<br>£'000  | 2010<br>£'000  |
|----------------------------------------------|------|----------------|----------------|
| <b>Assets</b>                                |      |                |                |
| <b>Non-current assets</b>                    |      |                |                |
| Property, plant and equipment                | 9    | 4,635          | 4,381          |
| Other receivables                            | 11   | 81             | 81             |
| <b>Total non-current assets</b>              |      | <b>4,716</b>   | <b>4,462</b>   |
| <b>Current assets</b>                        |      |                |                |
| Trade and other receivables                  | 11   | 941            | 1,045          |
| Derivative financial instruments             | 14   | 29             | 27             |
| Current tax receivable                       |      | 1,500          | 620            |
| Short-term investments                       | 12   | 8,000          | 25,000         |
| Cash and cash equivalents                    | 12   | 18,687         | 15,900         |
| <b>Total current assets</b>                  |      | <b>29,157</b>  | <b>42,592</b>  |
| <b>Liabilities</b>                           |      |                |                |
| <b>Current liabilities</b>                   |      |                |                |
| Trade and other payables                     | 13   | (4,570)        | (4,172)        |
| <b>Total current liabilities</b>             |      | <b>(4,570)</b> | <b>(4,172)</b> |
| <b>Net current assets</b>                    |      | <b>24,587</b>  | <b>38,420</b>  |
| <b>Non-current liabilities</b>               |      |                |                |
| Other payables                               | 13   | (1,667)        | (2,158)        |
| Provisions for other liabilities and charges | 15   | (228)          | (107)          |
| <b>Total non-current liabilities</b>         |      | <b>(1,895)</b> | <b>(2,265)</b> |
| <b>Net assets</b>                            |      | <b>27,408</b>  | <b>40,617</b>  |
| <b>Equity</b>                                |      |                |                |
| Share capital                                | 16   | 4,309          | 4,309          |
| Share premium account                        |      | 64,821         | 64,821         |
| Other reserve                                |      | 7,463          | 7,463          |
| Profit and loss account (deficit)            |      | (49,185)       | (35,976)       |
| <b>Total equity</b>                          |      | <b>27,408</b>  | <b>40,617</b>  |

The notes on pages 28 to 42 are an integral part of these consolidated financial statements

The financial statements on pages 24 to 42 were approved by the Board of Directors on 11 October 2011 and were signed on its behalf by



**Brian Count**  
Chairman



**Rex Vevers**  
Finance Director

Ceres Power Holdings plc  
Registered Number 5174075

## Consolidated Cash Flow Statement

for the year ended 30 June 2011

## Financial Statements

|                                                                     | Note | 2011<br>£'000   | 2010<br>£'000   |
|---------------------------------------------------------------------|------|-----------------|-----------------|
| <b>Cash flows from operating activities</b>                         |      |                 |                 |
| Cash used in operations                                             | 18   | (14,824)        | (10,820)        |
| Income tax received                                                 |      | 1,454           | 793             |
| <b>Net cash used in operating activities</b>                        |      | <b>(13,370)</b> | <b>(10,027)</b> |
| <b>Cash flows from investing activities</b>                         |      |                 |                 |
| Purchase of property, plant and equipment                           |      | (2,313)         | (2,814)         |
| Capital grant contributions to property, plant and equipment        |      | 831             | 252             |
| Redemption of financial assets at fair value through profit or loss |      | -               | 9,553           |
| Movement in short-term investments                                  |      | 17,000          | (25,000)        |
| Finance income received                                             |      | 628             | 454             |
| <b>Net cash generated from/(used in) investing activities</b>       |      | <b>16,146</b>   | <b>(17,555)</b> |
| <b>Cash flows from financing activities</b>                         |      |                 |                 |
| Proceeds from issuance of ordinary shares                           |      | -               | 31,556          |
| Net expenses of shares issued                                       |      | -               | (1,321)         |
| <b>Net cash generated from financing activities</b>                 |      | <b>-</b>        | <b>30,235</b>   |
| <b>Net increase in cash and cash equivalents</b>                    |      | <b>2,776</b>    | <b>2,653</b>    |
| Exchange gains on cash and cash equivalents                         |      | 11              | 41              |
| Cash and cash equivalents at beginning of year                      |      | 15,900          | 13,206          |
| <b>Cash and cash equivalents at end of year</b>                     | 12   | <b>18,687</b>   | <b>15,900</b>   |

## Consolidated Statement of Changes in Equity

for the year ended 30 June 2011

|                                   | Share<br>capital<br>£ 000 | Share<br>premium<br>account<br>£ 000 | Other<br>reserve<br>£ 000 | Profit<br>and loss<br>account<br>(deficit)<br>£ 000 | Total<br>£ 000 |
|-----------------------------------|---------------------------|--------------------------------------|---------------------------|-----------------------------------------------------|----------------|
| At 1 July 2009                    | 3,344                     | 35,551                               | 7,463                     | (24,965)                                            | 21,393         |
| <b>Comprehensive income</b>       |                           |                                      |                           |                                                     |                |
| Loss for the financial year       | -                         | -                                    | -                         | (11,723)                                            | (11,723)       |
| <b>Total comprehensive income</b> | -                         | -                                    | -                         | (11,723)                                            | (11,723)       |
| <b>Transactions with owners</b>   |                           |                                      |                           |                                                     |                |
| Issue of shares, net of costs     | 965                       | 29,270                               | -                         | -                                                   | 30,235         |
| Share-based payments charge       | -                         | -                                    | -                         | 712                                                 | 712            |
| <b>Transactions with owners</b>   | 965                       | 29,270                               | -                         | 712                                                 | 30,947         |
| At 30 June 2010                   | 4,309                     | 64,821                               | 7,463                     | (35,976)                                            | 40,617         |
| <b>Comprehensive income</b>       |                           |                                      |                           |                                                     |                |
| Loss for the financial year       | -                         | -                                    | -                         | (13,821)                                            | (13,821)       |
| <b>Total comprehensive income</b> | -                         | -                                    | -                         | (13,821)                                            | (13,821)       |
| <b>Transactions with owners</b>   |                           |                                      |                           |                                                     |                |
| Share-based payments charge       | -                         | -                                    | -                         | 612                                                 | 612            |
| <b>Transactions with owners</b>   | -                         | -                                    | -                         | 612                                                 | 612            |
| At 30 June 2011                   | 4,309                     | 64,821                               | 7,463                     | (49,185)                                            | 27,408         |

## Financial Statements

### Notes to the Consolidated Financial Statements for the year ended 30 June 2011

#### 1. Summary of significant accounting policies

The Company is incorporated and domiciled in the United Kingdom and is registered on the Alternative Investment Market ('AIM') of the London Stock Exchange

#### Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union, the IFRS Interpretations Committee (formerly the International Financial Reporting Interpretations Committee ('IFRIC')) interpretations and those parts of the Companies Act 2006 applicable to companies reporting under IFRS

The Company has elected to prepare its entity financial statements in accordance with United Kingdom Generally Accepted Accounting Practice ('UK GAAP') and these are presented on pages 44 to 48

The consolidated financial statements have been prepared on a historical cost basis except for certain items that have been measured at fair value as detailed in the individual accounting policies below

#### Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from these estimates

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised. Material estimates and assumptions are made in particular with regard to establishing uniform depreciation periods for the Group, choosing the appropriate method with which to recognise development-related revenue (revenue is recognised over the development phase of each contract based on the costs incurred ('percentage of completion')), and recognising R&D tax credits. The Directors continue to monitor the Group's financial plans and will take appropriate measures to maintain funding for the Group's operations

#### Basis of consolidation

The consolidated financial statements of Ceres Power Holdings plc include the results of the Company and its wholly owned subsidiaries

The financial statements of Ceres Power Limited have been consolidated under merger accounting rules. The financial statements of Ceres Intellectual Property Company Limited have been consolidated under acquisition accounting rules

Intra-Group transactions, profits, losses and balances are eliminated in full on consolidation

#### Capital risk management

The Group's objectives, when managing capital, are to safeguard the Group's ability to continue as a going concern and to maintain an optimal capital structure. Total capital, which is the Group's primary source of funding, is calculated as 'Total equity' as shown in the consolidated balance sheet. The Group's strategy for an optimal capital structure, which was unchanged from 2010, was to maintain a gearing ratio of zero. This has been achieved in both years. The Group also protects its capital by eliminating/hedging treasury risks that could expose the Group to the risk of material loss of capital (refer to note 14)

#### Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Historical cost includes all expenditure that is directly attributable to the acquisition of the assets. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the asset will flow to the Group and the cost of the asset can be measured reliably. All other repairs and maintenance costs are charged to the Consolidated Statement of Comprehensive Income during the financial period in which they are incurred

Depreciation is calculated using the straight-line method to allocate the cost over the estimated useful lives as follows

|                        |                                        |
|------------------------|----------------------------------------|
| Leasehold improvements | Ten years or the lease term if shorter |
| Plant and machinery    | Three to five years                    |
| Computer equipment     | Three years                            |
| Fixtures and fittings  | Three to ten years                     |

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

Assets under construction represent the cost of purchasing, constructing and installing property, plant and equipment ahead of their productive use. The category is temporary, pending completion of the assets and their transfer to the appropriate and permanent category of property, plant and equipment. As such, no depreciation is charged on assets under construction

#### Cash and cash equivalents

Cash and cash equivalents includes cash at bank and in hand, pooled money market funds and short-term deposits with an original maturity of less than or equal to three months, reduced by overdrafts to the extent that there is a right of offset against other cash balances

#### Short-term investments

These include short-term bank deposits with original maturity greater than three months and less than or equal to twelve months

#### Financial assets at fair value through profit or loss

The Group classifies its financial assets at fair value through profit or loss. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition

### 1. Summary of significant accounting policies continued

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Assets in this category are classified as current assets.

Financial assets carried at fair value through profit or loss are initially recognised at fair value. Gains and losses arising from changes in the fair value are presented in the Consolidated Statement of Comprehensive Income in the period in which they arise.

#### Trade and other receivables

Trade receivables are recognised and carried at the original invoice amount less an allowance for any uncollectable amounts that are made when the full amount is no longer considered receivable. Actual bad debts are written off when identified. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables.

#### Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

#### Taxation

The tax credit represents the best estimate of tax due to the Group at the year end.

Deferred tax is provided in full, using the liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred 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.

#### Share-based payments

The Group has a number of employee and executive share option and incentive schemes under which it makes equity-settled share-based payments. The fair value at the date of grant of equity-settled, share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. The charge is then credited back to reserves.

Fair value is measured by use of the Black-Scholes and binomial models. The expected lives used in the models have been adjusted, based on the Directors' best estimates, for the effects of non-transferability, exercise restrictions and behavioural considerations.

#### Foreign currencies

The consolidated financial statements are presented in pounds sterling, which is the Company's functional and presentational currency. Transactions denominated in foreign currencies are translated into sterling at the actual rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates ruling at the balance sheet date. Exchange differences are included in the Consolidated Statement of Comprehensive Income.

#### Pension scheme arrangements

The Group operates a defined contribution pension scheme for employees. The assets of the scheme are held separately from those of the Group. The pension costs charged represent contributions paid by the Group to individual pension plans and are charged to the Consolidated Statement of Comprehensive Income as they become payable.

In addition, a stakeholder pension scheme is also available to employees.

#### Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value added tax, other sales taxes and after eliminating sales within the Group. Amounts received or receivable under development contracts are recognised as revenue when earned, as calculated on a percentage of completion basis, based on costs incurred to total estimated costs over the period that the related work is performed, subject to certainty of receipt of cash, or when any specific conditions in agreements have been met. All costs relating to these development contracts are recorded as research and development expenditure. As revenue represents contributions towards costs incurred, no amounts have been allocated to cost of sales.

#### Government grants

Grants are recognised on a case-by-case basis. Revenue grants are recognised in the Consolidated Statement of Comprehensive Income as other operating income. Capital grants are recognised in property, plant and equipment against the assets to which they relate (and are fully disclosed in note 9 to the financial statements) and are credited to the Consolidated Statement of Comprehensive Income on a straight-line basis over the expected lives of the related assets as a reduced depreciation expense. For grants with no technical milestones, and where recovery is assured, the grant is recognised on an accruals basis in order to match the associated expenditure with the grant. For grants with technical milestones, grants are recognised only when the relevant milestone has been achieved and the associated cash has been received.

#### Research and development expenditure

Research costs are expensed as incurred. Development expenditure is capitalised when it can be separately measured and its future recoverability can be reasonably regarded as assured. Following initial recognition, the related asset is amortised over the period of expected future sales with impairment reviews being carried out at least annually. The asset is carried at cost less any accumulated amortisation and impairment losses. The Group has not yet capitalised any development costs as the criteria set out in IAS 38, 'Intangible assets', have not been met.

#### Operating 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 (net of any incentives received from the lessor) are charged to the Consolidated Statement of Comprehensive Income on a straight-line basis over the period of the lease. Benefits received and receivable as an incentive to sign an operating lease are amortised over the full lease term.

## Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

## Financial Statements

### 1. Summary of significant accounting policies continued

#### Derivative financial instruments

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates. The Group uses forward foreign exchange contracts to hedge against foreign currency denominated purchase commitments. The use of financial derivatives is governed by the Group's treasury policy, as approved by the Board. The Group does not use derivative financial instruments for speculative purposes. Details of financial instruments are shown in note 14.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the Consolidated Statement of Comprehensive Income as they arise.

#### Provisions

Provisions have been made for future dilapidations costs on leased property. These provisions are the Directors' best estimates as the actual costs and timing of future cash flows are dependent on future events. Any difference between expectations and the actual future liability will be accounted for in the period when such determination is made. Details of the Group's provisions are set out in note 15.

a) Standards, amendments and interpretations effective for the first time in the year ended 30 June 2011

*Amendment to IAS 32 on classification of rights issues*

*Amendments to IFRS 2, Share-based payments group cash-settled transactions*

*Annual improvements 2009*

*IFRIC 18, 'Transfer of assets from customers'*

*IFRIC 19, 'Extinguishing financial liabilities with equity instruments'*

*Amendments to IFRIC 9 and IAS 39 regarding embedded derivatives*

None of these have had any impact on the reported results of the Group.

b) Standards, amendments and interpretations that are not yet effective and have not been early adopted

*Amendment to IAS 24, 'Related party disclosures'*

*Amendment to IFRIC 14, 'Prepayments of minimum funding requirement'*

*Annual improvements 2010*

The Directors do not anticipate that the adoption of these standards, amendments and interpretations, where relevant, in future periods will have a material impact on the Group's financial statements.

c) Standards, amendments and interpretations that are not yet effective and have not yet been endorsed by the EU

*IAS 19 (revised 2011), 'Employee benefits'*

*Amendment to IAS 1, 'Financial statement presentation' on other comprehensive income (OCI)*

*Amendments to IFRS 7 on derecognition*

*Amendment to IAS 12, 'Income taxes' on deferred tax*

*IFRS 9, 'Financial instruments' on 'Classification and measurement' of financial assets*

*IFRS 9, 'Financial instruments' on 'Classification and measurement' of financial liabilities*

*IFRS 10, 'Consolidated financial statements'*

*IFRS 11, 'Joint arrangements'*

*IFRS 12, 'Disclosure of interests in other entities'*

*IFRS 13, 'Fair value measurement'*

*IAS 27 (revised), 'Separate financial statements'*

*IAS 28 (revised), 'Investments in associates and joint ventures'*

The Directors do not anticipate that the adoption of these standards, amendments and interpretations, where relevant, in future periods will have a material impact on the Group's financial statements.

### 2 Revenue and segmental information

For the year ended 30 June 2011 the Group's revenue and losses were derived from its principal activity, within the United Kingdom and Europe (2010: United Kingdom and Europe). For management purposes, the Group is organised into one operating segment, which is the development of microgeneration products based on solid oxide fuel cell technology.

The Group has adopted IFRS 8, 'Operating Segments'. IFRS 8 defines operating segments as those activities of an entity about which separate financial information is available and which are evaluated by the Chief Operating Decision Maker to assess performance and determine the allocation of resources. The Chief Operating Decision Maker has been identified as the Executive Directors of Ceres Power Holdings plc. The Directors are of the opinion that under IFRS 8 the Group has only one operating segment, being the development of microgeneration products based on solid oxide fuel cell technology. The Executive Directors of Ceres Power Holdings plc assess the performance of the operating segment on financial information which is measured and presented in a manner consistent with that in the financial statements.

All of the Group's revenue is derived from its three primary customers, £524,000 of which is from the United Kingdom and £168,000 from the Republic of Ireland (2010: United Kingdom £693,000, Republic of Ireland £93,000). All of the Group's non-current assets are located in the United Kingdom.

**3 Loss before income tax**

|                                              | 2011<br>£'000 | 2010<br>£ 000 |
|----------------------------------------------|---------------|---------------|
| <b>Operating costs are split as follows.</b> |               |               |
| Research and development costs               | 12,869        | 9,907         |
| Administrative expenses                      | 4,833         | 4,636         |
|                                              | <b>17,702</b> | <b>14,543</b> |

**Loss before income tax is stated after charging/(crediting):**

|                                                                                      |       |       |
|--------------------------------------------------------------------------------------|-------|-------|
| Staff costs, including share-based payments charges (note 5)                         | 8,201 | 6,189 |
| Depreciation on property, plant and equipment (net of amortised grant contributions) | 1,296 | 1,115 |
| Operating lease rentals payable                                                      |       |       |
| – plant and machinery                                                                | 25    | 10    |
| – property                                                                           | 390   | 429   |
| Other operating income – grant income                                                | (352) | (570) |
| Repairs expenditure on property, plant and equipment                                 | 168   | 99    |
| Forward contract gains                                                               | (2)   | (55)  |
| Net foreign exchange losses                                                          | 18    | 41    |

**Services provided by the Group's auditors**

During the year the Group obtained the following services from the Group's auditors as detailed below

|                                                                                                                           |           |           |
|---------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
| – remuneration receivable by the Company's auditors for the audit of parent Company and consolidated financial statements | 17        | 14        |
| – auditing of financial statements of subsidiaries of the Company pursuant to legislation                                 | 32        | 28        |
| – other services pursuant to legislation                                                                                  | 9         | 9         |
| – other services relating to taxation                                                                                     | 28        | 27        |
| – other services                                                                                                          | 4         | 6         |
|                                                                                                                           | <b>90</b> | <b>84</b> |

**4 Finance income**

|                                                            | 2011<br>£'000 | 2010<br>£ 000 |
|------------------------------------------------------------|---------------|---------------|
| Fair value loss on UK Government gilts                     | –             | (119)         |
| Interest receivable on net cash and short-term investments | 503           | 490           |
|                                                            | <b>503</b>    | <b>371</b>    |

**5 Employees and Directors**

The average monthly number of persons (including Executive Directors) employed by the Group during the year was

|                          | 2011<br>Number | 2010<br>Number |
|--------------------------|----------------|----------------|
| By activity              |                |                |
| Research and development | 105            | 70             |
| Administration           | 33             | 30             |
|                          | <b>138</b>     | <b>100</b>     |

## Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

### Financial Statements

#### 5 Employees and Directors continued

|                                                               | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------------------------|---------------|---------------|
| <b>Staff costs (for the above persons) comprised</b>          |               |               |
| Wages and salaries, including compensation for loss of office | 6,478         | 4,671         |
| Social security costs                                         | 731           | 478           |
| Other pension costs (note 6)                                  | 380           | 328           |
| Share-based payments (note 17)                                | 612           | 712           |
|                                                               | <b>8,201</b>  | <b>6,189</b>  |
|                                                               |               |               |
|                                                               | 2011<br>£'000 | 2010<br>£'000 |
| <b>Directors' emoluments</b>                                  |               |               |
| Aggregate emoluments                                          | 794           | 668           |
| Company contributions to defined contribution pension schemes | 45            | 37            |
| Compensation for loss of office                               | 285           | —             |
|                                                               | <b>1,124</b>  | <b>705</b>    |
|                                                               |               |               |
|                                                               | 2011<br>£'000 | 2010<br>£'000 |
| <b>Highest paid Director</b>                                  |               |               |
| Aggregate emoluments                                          | 204           | 197           |
| Company contributions to defined contribution pension schemes | 14            | 17            |
|                                                               | <b>218</b>    | <b>214</b>    |

Two Directors (2010: three Directors) have retirement benefits accruing under defined contribution pension schemes

Detailed disclosures of Directors' emoluments and interests in share options are shown in the Remuneration Report on pages 16 to 20

#### Key management compensation

The Directors are of the opinion that the key management of the Group are the Executive Directors of Ceres Power Holdings plc. The key management compensation is summarised in the following table

|                                                   | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------------|---------------|---------------|
| Salaries and other short-term employment benefits | 554           | 428           |
| Post-employment benefits                          | 45            | 37            |
| Termination benefits                              | 285           | —             |
| Share-based payments                              | 363           | 368           |
|                                                   | <b>1,247</b>  | <b>833</b>    |

#### 6 Pensions

The Group operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the Group in independently administered funds. The pension charge represents contributions payable by the Group to the funds and amounted to £380,000 (2010: £328,000). A total of £45,000 was payable to the funds at the year end (2010: £41,000).

**7 Income tax credit**

|                                                         | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------------------|---------------|---------------|
| UK corporation tax – R&D tax credit                     | (1,500)       | (620)         |
| Adjustment in respect of prior periods – R&D tax credit | (834)         | (473)         |
| Income tax (credit)                                     | (2,334)       | (1,093)       |

No corporation tax liability has arisen during the year (2010 £nil) due to the losses incurred

A tax credit has arisen as a result of the tax losses being surrendered in respect of research and development expenditure in the current and prior years

The tax result for the year is different from the standard rate of small profits UK corporation tax of 20.75% (2010 21%). The differences are explained below

|                                                                           | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------------------------------------|---------------|---------------|
| Loss before income tax                                                    | (16,155)      | (12,816)      |
| Loss before income tax multiplied by the UK tax rate of 20.75% (2010 21%) | (3,352)       | (2,692)       |
| Effects of                                                                |               |               |
| Losses carried forward                                                    | 1,790         | 1,732         |
| Enhanced tax deductions for R&D expenditure                               | (1,019)       | (435)         |
| Expenses not deductible for tax purposes                                  | 142           | 231           |
| Accelerated capital allowances and other timing differences               | 216           | 234           |
| Adjustment in respect of prior periods – R&D tax credit                   | (834)         | (473)         |
| Difference between R&D tax credit and small company tax rates             | 723           | 310           |
| Total income tax (credit)                                                 | (2,334)       | (1,093)       |

During the year, the change in the small profits UK corporation tax rate, which was effective from 1 April 2011, reduced the tax rate to 20% (2010 21%)

**8. Loss per share**

Basic and diluted loss per £0.05 ordinary share are calculated by dividing the loss for the financial year attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year. Given the losses during the year, there is no dilution of losses per share in the year ended 30 June 2011 or in the previous year.

The loss for the financial year ended 30 June 2011 was £13,821,000 (2010 £11,723,000) and the weighted average number of £0.05 ordinary shares in issue during the year ended 30 June 2011 was 86,177,614 (2010 77,349,920).

## Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

## Financial Statements

### 9 Property, plant and equipment

|                                     | Leasehold improvements<br>£ 000 | Plant and machinery<br>£ 000 | Computer equipment<br>£ 000 | Fixtures and fittings<br>£'000 | Assets under construction<br>£ 000 | Total<br>£ 000 |
|-------------------------------------|---------------------------------|------------------------------|-----------------------------|--------------------------------|------------------------------------|----------------|
| <b>Cost</b>                         |                                 |                              |                             |                                |                                    |                |
| At 1 July 2009                      | 1,334                           | 3,432                        | 474                         | 93                             | 1,328                              | 6,661          |
| Additions                           | 451                             | 613                          | 173                         | 31                             | 1,436                              | 2,704          |
| Grant contributions                 | (179)                           | (141)                        | –                           | –                              | (131)                              | (451)          |
| Transfers                           | 710                             | 618                          | –                           | –                              | (1,328)                            | –              |
| At 30 June 2010                     | 2,316                           | 4,522                        | 647                         | 124                            | 1,305                              | 8,914          |
| Additions                           | 367                             | 1,430                        | 132                         | 14                             | 280                                | 2,223          |
| Grant contributions                 | (74)                            | (712)                        | (18)                        | –                              | 131                                | (673)          |
| Transfers                           | 37                              | 1,397                        | –                           | 2                              | (1,436)                            | –              |
| <b>At 30 June 2011</b>              | <b>2,646</b>                    | <b>6,637</b>                 | <b>761</b>                  | <b>140</b>                     | <b>280</b>                         | <b>10,464</b>  |
| <b>Depreciation</b>                 |                                 |                              |                             |                                |                                    |                |
| At 1 July 2009                      | 615                             | 2,382                        | 354                         | 67                             | –                                  | 3,418          |
| Charge for the year                 | 245                             | 789                          | 79                          | 13                             | –                                  | 1,126          |
| Amortisation of grant contributions | (5)                             | (6)                          | –                           | –                              | –                                  | (11)           |
| At 30 June 2010                     | 855                             | 3,165                        | 433                         | 80                             | –                                  | 4,533          |
| Charge for the year                 | 342                             | 1,024                        | 122                         | 22                             | –                                  | 1,510          |
| Amortisation of grant contributions | (15)                            | (197)                        | (2)                         | –                              | –                                  | (214)          |
| <b>At 30 June 2011</b>              | <b>1,182</b>                    | <b>3,992</b>                 | <b>553</b>                  | <b>102</b>                     | <b>–</b>                           | <b>5,829</b>   |
| <b>Net book value</b>               |                                 |                              |                             |                                |                                    |                |
| <b>At 30 June 2011</b>              | <b>1,464</b>                    | <b>2,645</b>                 | <b>208</b>                  | <b>38</b>                      | <b>280</b>                         | <b>4,635</b>   |
| At 30 June 2010                     | 1,461                           | 1,357                        | 214                         | 44                             | 1,305                              | 4,381          |
| At 30 June 2009                     | 719                             | 1,050                        | 120                         | 26                             | 1,328                              | 3,243          |

### 10 Subsidiary undertakings

Details of the Company's subsidiaries at 30 June 2011 are as follows

| Name of undertaking                         | Country of incorporation | Description of shares held | Proportion of nominal value of shares held by the Company |
|---------------------------------------------|--------------------------|----------------------------|-----------------------------------------------------------|
| Ceres Power Limited                         | England and Wales        | £0.001 ordinary shares     | 100%                                                      |
| Ceres Intellectual Property Company Limited | England and Wales        | £1.00 ordinary share       | 100%                                                      |

The principal activity of Ceres Power Limited is the development and commercial exploitation of microgeneration products based on solid oxide fuel cell technology. The principal activity of Ceres Intellectual Property Company Limited is the administration of registered intellectual property developed within the Group. The results of Ceres Power Limited and Ceres Intellectual Property Company Limited are included within these consolidated financial statements.

**11 Trade and other receivables**

|                                | 2011<br>£'000 | 2010<br>£'000 |
|--------------------------------|---------------|---------------|
| <b>Current</b>                 |               |               |
| Other receivables              | 452           | 306           |
| Prepayments and accrued income | 489           | 739           |
|                                | <b>941</b>    | <b>1,045</b>  |
| <b>Non-current</b>             |               |               |
| Prepayments and accrued income | 81            | 81            |
|                                | <b>1,022</b>  | <b>1,126</b>  |

There is no difference between the fair value of trade and other receivables and their carrying values and they are not overdue at 30 June 2011. There have been no provisions for impairment of receivables during the year (2010: £nil). The carrying amounts of the Group's trade and other receivables are all denominated in pounds sterling.

**12 Cash and cash equivalents and short-term investments**

|                                         | 2011<br>£'000 | 2010<br>£'000 |
|-----------------------------------------|---------------|---------------|
| Cash at bank and in hand                | 1,265         | 1,033         |
| Money market funds                      | 4,537         | 5,826         |
| Short-term bank deposits < three months | 12,885        | 9,041         |
| Cash and cash equivalents               | <b>18,687</b> | <b>15,900</b> |
| Short-term bank deposits > three months | 8,000         | 25,000        |
|                                         | <b>26,687</b> | <b>40,900</b> |

The Group holds surplus funds in accordance with the treasury policy, as set out in note 14.

|                                                                   | Interest<br>rate type | 2011<br>£'000 | 2010<br>£'000 |
|-------------------------------------------------------------------|-----------------------|---------------|---------------|
| <b>Interest rate risk profile of the Group's financial assets</b> |                       |               |               |
| Cash at bank and in hand                                          | Floating              | 1,265         | 1,033         |
| Money market funds                                                | Floating              | 4,537         | 5,826         |
| Short-term bank deposits < three months                           | Floating              | 9,885         | 9,041         |
| Short-term bank deposits < three months                           | Fixed                 | 3,000         | -             |
| Short-term bank deposits > three months                           | Fixed                 | 8,000         | 25,000        |
|                                                                   |                       | <b>26,687</b> | <b>40,900</b> |

The fixed rate short-term bank deposits in pounds sterling during the year were placed for fixed terms of between seven and twelve months and earned interest between 1.25% and 2.20% (2010: fixed terms of between seven and twelve months and earned interest between 1.50% and 2.20%). Floating rate cash deposits, money market funds and other bank deposits earned interest based on relevant UK LIBID-related equivalents. The credit quality of financial assets has been assessed by reference to external credit ratings (Fitch). Money market funds had ratings of AAA and all short-term bank deposits had ratings of AA in both 2010 and 2011.

**Borrowing facilities**

The Group had no undrawn committed borrowing facilities available during the year covered by the financial statements (2010: none).

## Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

## Financial Statements

### 13. Trade and other payables

|                              | 2011<br>£'000 | 2010<br>£'000 |
|------------------------------|---------------|---------------|
| <b>Current</b>               |               |               |
| Trade payables               | 1,404         | 1,189         |
| Taxation and social security | 372           | 193           |
| Other payables               | 159           | 55            |
| Accruals and deferred income | 2,635         | 2,735         |
|                              | <b>4,570</b>  | <b>4,172</b>  |
| <b>Non-current:</b>          |               |               |
| Accruals and deferred income | 1,667         | 2,158         |

### 14. Financial instruments

The Group only uses derivative financial instruments to hedge foreign currency exposures arising from an underlying current or anticipated business requirement and not for any speculative purpose. The Group does not currently use derivative instruments to manage its interest rate risk. The Group does not trade in financial instruments.

#### Fair values of financial assets and financial liabilities

There is no difference between the fair value and the carrying value of the Group's financial assets and financial liabilities. Carrying value approximates to fair value because of the short maturity periods of these financial instruments.

#### Financial risk management

The Group's operations expose it to a variety of financial risks that include credit risk and market risk arising from changes to foreign currency exchange rates and interest rates. The Board reviews and agrees policies for managing each of these risks.

The principal risks addressed are as follows:

#### Credit risk

The Group's exposure to credit risk arises from holdings of cash and cash equivalents and short-term investments. The Group's primary objective to manage credit risk is to minimise the risk of a loss of capital and eliminate loss of liquidity having a detrimental effect on the business.

The Group typically places surplus funds into pooled money market funds, bank deposits with durations of up to twelve months and UK Government gilts with durations of up to twelve months. The Group's treasury policy restricts investments in short-term sterling money market funds to those which carry short-term credit ratings of at least two of AA-Am (Standard & Poor's), Aaa/MR1+ (Moody's) and AAA V1+ (Fitch) and deposits with banks with minimum long-term rating of AA-/AA-/Aa3 and short-term rating of F1+/A-/P-1 for banks which the UK Government holds less than 25% ordinary equity.

#### Interest rate risk

Interest rate risk on the Group's liabilities is minimal.

The Group's finance income is sensitive to changes in interest rates. A change of 1% in interest rates would have impacted the finance income by £0.3 million in the year ended 30 June 2011 (2010: £0.3 million).

#### Liquidity risk

Cash flow forecasting is performed by the Group. This includes forecasting of the Group's liquidity requirements to ensure the Group has sufficient cash to meet its operational needs.

#### Foreign currency exposures

The Group seeks to minimise its exposure to fluctuations in exchange rates by taking out forward currency contracts to hedge against foreign currency denominated commitments, when known. At 30 June 2011, 100% (2010: 100%) of foreign currency commitments were hedged by foreign currency contracts. Fair value is based on the market price of comparable instruments at the balance sheet date.

The Group's gross forward currency contracts are all due in less than one year. The mark to market gains of the forward currency contracts in the Consolidated Statement of Comprehensive Income were £2,000 (2010: gains of £55,000).

**14 Financial instruments continued**

The following table presents the Group's assets and liabilities that are measured at fair value at 30 June 2011

|                                                              | Level 2<br>2011<br>£'000 | Level 2<br>2010<br>£'000 |
|--------------------------------------------------------------|--------------------------|--------------------------|
| <b>Financial assets at fair value through profit or loss</b> |                          |                          |
| Derivatives used for hedging                                 | 29                       | 27                       |

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

The table below shows the extent to which the Group has monetary assets and liabilities in currencies other than pounds sterling. Foreign exchange differences arising on the retranslation of these monetary assets and liabilities are taken to the Consolidated Statement of Comprehensive Income.

|                                          | 2011<br>£'000 | 2010<br>£'000 |
|------------------------------------------|---------------|---------------|
| <b>Foreign currency monetary assets:</b> |               |               |
| United States dollar                     | 77            | 52            |
| Euro                                     | 180           | 47            |
|                                          | <b>257</b>    | <b>99</b>     |

The Group has net euro denominated trade payables of £139,000 (2010: £113,000) and US dollar denominated trade payables of £26,000 (2010: £183,000).

The functional currency of the Company is pounds sterling.

**15 Provisions for other liabilities and charges**

Property dilapidation provisions charged to the Consolidated Statement of Comprehensive Income are set out below.

|                                                               | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------------------------|---------------|---------------|
| At 1 July                                                     | 107           | 30            |
| Charged to the Consolidated Statement of Comprehensive Income | 121           | 77            |
| At 30 June                                                    | <b>228</b>    | <b>107</b>    |

The provision recognised is being built up to match the present value of costs to be incurred, which is materially the same as the expected costs to be incurred, in making good the various leasehold properties at the end of their respective leases, details of which are in note 19.

**Deferred taxation**

Potential deferred tax assets have not been recognised but are set out below.

|                                                        | 2011<br>£'000   | 2010<br>£'000  |
|--------------------------------------------------------|-----------------|----------------|
| <b>Tax effect of temporary differences because of</b>  |                 |                |
| Difference between capital allowances and depreciation | (702)           | (668)          |
| Deductions relating to share options                   | (72)            | (275)          |
| Losses carried forward                                 | (9,580)         | (8,662)        |
| Pensions                                               | -               | (11)           |
|                                                        | <b>(10,354)</b> | <b>(9,616)</b> |

The deferred tax assets have not been recognised as the Directors consider that it is unlikely that the asset will be realised in the foreseeable future.

## Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

## Financial Statements

### 16. Share capital

|                                          | 2011        |       | 2010        |       |
|------------------------------------------|-------------|-------|-------------|-------|
|                                          | Number      | £'000 | Number      | £'000 |
| <b>Authorised</b>                        |             |       |             |       |
| Ordinary shares of £0.05 each            | 100,000,000 | 5,000 | 100,000,000 | 5,000 |
| <b>Allotted and fully paid</b>           |             |       |             |       |
| <b>At 1 July</b>                         | 86,177,614  | 4,309 | 66,874,075  | 3,344 |
| Allotted under share option schemes      | -           | -     | 303,539     | 15    |
| Allotted on cash placing                 | -           | -     | 19,000,000  | 950   |
| Ordinary shares of £0.05 each at 30 June | 86,177,614  | 4,309 | 86,177,614  | 4,309 |

During the year the Company did not issue any shares and no employee share options were exercised. (2010: the Company issued 19,000,000 ordinary shares of £0.05 each, in a placing approved by shareholders on 14 December 2009, for a cash consideration of £31,350,000 (excluding issue costs of £1,321,580). Also, 303,539 ordinary shares of £0.05 each were issued on the exercise of employee share options for cash consideration of £206,347.)

### 17 Share options

The total charge recognised in the year ended 30 June 2011 relating to employee share-based payments was £612,000 (2010: £712,000).

The Company has a number of share option schemes and savings-related share option plans for its employees and a separate scheme for Executive Directors.

|                                        | 2011<br>£'000 | 2010<br>£'000 |
|----------------------------------------|---------------|---------------|
| a) 2004 Employees' share option scheme | 55            | 166           |
| b) Executive Directors' one-off award  | 370           | 421           |
| c) 2009 Sharesave scheme               | 34            | 34            |
| d) CHP Project Bonus plan              | 131           | 89            |
| e) 2010 Sharesave scheme               | 18            | 2             |
| f) 2011 Sharesave scheme               | 4             | -             |
|                                        | 612           | 712           |

#### a) Ceres Power Holdings Limited 2004 Employees' share option scheme

The Company has issued share options under this scheme for Directors and employees, under which approved and unapproved share options were granted, prior to the flotation of the Company in November 2004. The Company adopted the 'Ceres Power Holdings Limited 2004 Employees' share option scheme' at the time of flotation.

Under this scheme, Directors and employees hold options to subscribe for £0.05 ordinary shares in Ceres Power Holdings plc at prices ranging from £0.23 to the closing mid-market price on the day preceding the most recent share option grant. All options are equity-settled. The vesting period for all options is generally three years. If the options remain unexercised after a period of ten years from the date of the grant, the options expire. Options are forfeited if the employee leaves the Group before the options vest.

**17 Share options continued**

Movements in the total number of share options outstanding and their relative weighted average exercise price are as follows

|                        | 2011          |                                 | 2010          |                                 |
|------------------------|---------------|---------------------------------|---------------|---------------------------------|
|                        | Number ('000) | Weighted average exercise price | Number ('000) | Weighted average exercise price |
| Outstanding at 1 July  | 5,957         | £0 95                           | 6,348         | £0 96                           |
| Granted                | -             | -                               | 5             | £1 07                           |
| Exercised              | -             | -                               | (304)         | £0 68                           |
| Lapsed                 | (175)         | £1 27                           | (92)          | £2 83                           |
| Outstanding at 30 June | 5,782         | £0 94                           | 5,957         | £0 95                           |
| Exercisable            | 5,696         | £0 92                           | 5,651         | £0 93                           |

No options were granted or exercised in the year (2010 the weighted average fair value of options granted was £6,368 The weighted average share price at the date of exercise was £1 93)

The range of exercise prices for options outstanding at the end of the year is as follows

| Expiry date – 30 June | 2011                            |               | 2010                            |               |
|-----------------------|---------------------------------|---------------|---------------------------------|---------------|
|                       | Weighted average exercise price | Number ('000) | Weighted average exercise price | Number ('000) |
| 2012                  | £0.23                           | 193           | £0 23                           | 193           |
| 2013                  | £0.29                           | 1,557         | £0 29                           | 1,557         |
| 2014                  | £0 41                           | 1,940         | £0 41                           | 1,955         |
| 2015                  | £0 77                           | 252           | £0 77                           | 252           |
| 2016                  | £2 38                           | 922           | £2 38                           | 922           |
| 2017                  | £2 24                           | 420           | £2 24                           | 445           |
| 2018                  | £2 00                           | 170           | £1 95                           | 185           |
| 2019                  | £1 20                           | 323           | £1 34                           | 443           |
| 2020                  | £1.07                           | 5             | £1 07                           | 5             |

The options outstanding at the end of the year have a weighted average contractual life of 3 14 years (2010 4 37 years)

**b) Executive Directors' one-off award**

No options were granted during the year (2010 one Executive Director was granted 212,500 'one-off' options under the Company's 2004 Employees' share option scheme at an exercise price of £2 00, a premium of £0 05 to the then market price) The exercise of these share options is usually subject to continued employment and achievement of absolute share price targets

All 'one-off' options remain outstanding and unexercisable at 30 June 2011 The weighted average fair value of the options granted in 2010 was £242,411 No options were exercised and 318,750 options lapsed during the year (2010 no options were exercised or lapsed)

The expiry dates of options outstanding at the end of the year are as follows

| Expiry date – 30 June | 2011                            |               | 2010                            |               |
|-----------------------|---------------------------------|---------------|---------------------------------|---------------|
|                       | Weighted average exercise price | Number ('000) | Weighted average exercise price | Number ('000) |
| 2018                  | £2 00                           | 1,687,500     | £2 00                           | 2,006,250     |
| 2019                  | £2 00                           | 212,500       | £2 00                           | 212,500       |

The options outstanding at the end of the year have a weighted average contractual life of 7 57 years (2010 8 56 years)

The Remuneration Report highlights the performance criteria of these options

## Financial Statements

### Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

#### 17 Share options continued

##### c) Ceres Power Holdings Sharesave scheme

During the year, a third HMRC-approved savings-related share option scheme was implemented, under which employees save on a monthly basis, over a three-year period, towards the purchase of shares at a fixed price determined when the option is granted. This price is set at a 20% discount to the market price. The options must be exercised within six months of maturity of the savings contract, otherwise they lapse.

Movements in the total number of share options outstanding and their relative weighted average exercise price are as follows:

|                        | 2011          |                                 | 2010          |                                 |
|------------------------|---------------|---------------------------------|---------------|---------------------------------|
|                        | Number ('000) | Weighted average exercise price | Number ('000) | Weighted average exercise price |
| Outstanding at 1 July  | 289           | £0.90                           | 227           | £0.81                           |
| Granted                | 574           | £0.40                           | 88            | £1.12                           |
| Lapsed                 | (117)         | £0.96                           | (26)          | £0.81                           |
| Outstanding at 30 June | 746           | £0.51                           | 289           | £0.90                           |
| Exercisable            | —             | —                               | —             | —                               |

The weighted average fair value of options granted in the year was £157,847 (2010: £67,828).

The expiry dates of options outstanding at the end of the year are as follows:

|                       | 2011                                       |               | 2010                                       |               |
|-----------------------|--------------------------------------------|---------------|--------------------------------------------|---------------|
|                       | Actual and weighted average exercise price | Number ('000) | Actual and weighted average exercise price | Number ('000) |
| Expiry date – 30 June |                                            |               |                                            |               |
| 2013                  | £0.81                                      | 139           | £0.81                                      | 201           |
| 2014                  | £1.12                                      | 33            | £1.12                                      | 88            |
| 2015                  | £0.40                                      | 574           | —                                          | —             |

The options outstanding at the end of the year have a weighted average contractual life of 3.01 years (2010: 2.73 years).

##### d) CHP Project Bonus plan

The CHP Project Bonus plan is a medium-term incentive scheme under which a performance-related bonus of cash and nominal value share options is awarded to Executive Directors and senior managers. The exercise of these share options is usually subject to continued employment until 30 June 2012, when they vest, and they must be exercised by 30 June 2013.

Options relating to the Beta phase of the CHP Project Bonus plan were granted in the year ended 30 June 2011 (2010: nil).

Movements in the total number of share options outstanding and their relative weighted average exercise price are as follows:

|                        | 2011          |                                            | 2010          |                                            |
|------------------------|---------------|--------------------------------------------|---------------|--------------------------------------------|
|                        | Number ('000) | Actual and weighted average exercise price | Number ('000) | Actual and weighted average exercise price |
| Outstanding at 1 July  | 167           | £0.05                                      | 182           | £0.05                                      |
| Granted                | 160           | £0.05                                      | —             | —                                          |
| Lapsed                 | (16)          | £0.05                                      | (15)          | £0.05                                      |
| Outstanding at 30 June | 311           | £0.05                                      | 167           | £0.05                                      |
| Exercisable            | 38            | £0.05                                      | —             | —                                          |

The weighted average fair value of options granted in the year was £105,138 (2010: £nil). All options expire in the year ending 30 June 2013 and the options outstanding at the end of the year have a weighted average contractual life of 2.0 years (2010: 3.0 years).

## 17 Share options continued

### Assumptions

Fair values of all schemes, apart from the Executive Directors' one-off award, which was measured using a binomial pricing model, were measured by use of the Black-Scholes pricing model. The inputs to the Black-Scholes model were as follows

|                                     | CHP<br>Project<br>Bonus<br>plan<br>2011 | Sharesave<br>scheme<br>2011 | 2004<br>scheme<br>2010 | Sharesave<br>scheme<br>2010 |
|-------------------------------------|-----------------------------------------|-----------------------------|------------------------|-----------------------------|
|                                     | 7 July<br>2010                          | 22 April<br>2011            | 8 October<br>2009      | 1 June<br>2010              |
| Grant date                          |                                         |                             |                        |                             |
| Share price at date of grant (£)    | 0.70                                    | 0.50                        | 1.85                   | 1.40                        |
| Exercise price (£)                  | 0.05                                    | 0.40                        | 1.07                   | 1.12                        |
| Expected volatility (%)             | 65                                      | 65                          | 65                     | 65                          |
| Expected option life (years)        | 0.5                                     | 3.5                         | 5                      | 3.5                         |
| Average risk-free interest rate (%) | 3.5                                     | 3.5                         | 3.5                    | 3.5                         |
| Expected dividend yield             | Nil                                     | Nil                         | Nil                    | Nil                         |

The inputs to the binomial pricing model were as follows

|                                     | One off<br>award 2011 | One off<br>award 2010 |
|-------------------------------------|-----------------------|-----------------------|
| Grant date                          |                       | 1 September<br>2010   |
| Share price at date of grant (£)    | -                     | 1.95                  |
| Exercise price (£)                  | -                     | 2.00                  |
| Expected volatility (%)             | -                     | 70                    |
| Expected option life (years)        | -                     | 7                     |
| Average risk-free interest rate (%) | -                     | 4.0                   |

In addition, a discount of 14% was applied to take account of the 'one-off' options requiring the share price to achieve the target share price for a period of twenty consecutive days during the exercise period

The exercise prices of options are stated above. The expected life of the options is based on the best estimate of the average number of years expected from grant to exercise. The expected volatility is based on historical volatility of the Company's shares since it was listed on AIM. The risk-free rate of return is management's estimate of the yield on zero-coupon UK Government bonds of a term consistent with the expected option life.

## 18 Cash used in operations

|                                                                                      | 2011<br>£'000   | 2010<br>£'000   |
|--------------------------------------------------------------------------------------|-----------------|-----------------|
| <b>Loss before income tax</b>                                                        | <b>(16,155)</b> | <b>(12,816)</b> |
| <b>Adjustments for:</b>                                                              |                 |                 |
| Fair value loss on UK Government gilts                                               | -               | 119             |
| Other finance income                                                                 | (503)           | (490)           |
| Depreciation of property, plant and equipment (net of amortised grant contributions) | 1,296           | 1,115           |
| Share-based payments charge                                                          | 612             | 712             |
| <b>Operating cash flows before movements in working capital</b>                      | <b>(14,750)</b> | <b>(11,360)</b> |
| (Increase) in trade and other receivables                                            | (23)            | (477)           |
| (Decrease)/increase in trade and other payables                                      | (172)           | 940             |
| Increase in provisions                                                               | 121             | 77              |
| (Increase)/decrease in working capital                                               | (74)            | 540             |
| <b>Cash used in operations</b>                                                       | <b>(14,824)</b> | <b>(10,820)</b> |

## Notes to the Consolidated Financial Statements

for the year ended 30 June 2011 continued

## Financial Statements

### 19 Operating lease commitments

The Group leases premises and office equipment under non-cancellable operating lease agreements. The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

|                                                  | 2011                        |                | 2010                        |                |
|--------------------------------------------------|-----------------------------|----------------|-----------------------------|----------------|
|                                                  | Land and buildings<br>£'000 | Other<br>£'000 | Land and buildings<br>£'000 | Other<br>£'000 |
| No later than one year                           | 421                         | 33             | 456                         | 12             |
| Later than one year and no later than five years | 1,138                       | 63             | 1,115                       | 38             |
| Later than five years                            | 200                         | –              | 131                         | –              |
|                                                  | <b>1,759</b>                | <b>96</b>      | <b>1,702</b>                | <b>50</b>      |

The property leases have an average minimum term of 5.4 years (2010: 3.8 years). The rentals are fixed for the lease terms subject to periodic rent reviews. The office equipment leases have an average term of 1.7 years (2010: 4.4 years).

### 20 Contingent liabilities

During the year, the Group recognised grant income in respect of research and development activities of £352,000 as other income (see note 3) (2010: £570,000), £673,000 as a contribution to property, plant and equipment (see note 9) (2010: £451,000) and £nil as a prepayment relating to property, plant and equipment (2010: £165,000) in accordance with the Group's accounting policy. The Directors consider that there is a contingent liability only in respect of grants received in the twelve months prior to the balance sheet date. The repayment of grants received prior to this is considered of remote likelihood, as grants may be required to be repaid if the Group does not meet subsequent reporting requirements as specified in the grant offer letters. In addition £705,000 (2010: £705,000) of grants received, or an element thereof, may require repayment if the Group generates revenue (net of expenses and reasonable overheads) from the patent created from the grant. In such case, the Group may be liable to pay back the grant at a rate of 5% of the net revenue generated in any one year. The Directors of the Group believe it is unlikely that any of the grants received will need to be repaid in the foreseeable future.

### 21. Capital commitments

Capital expenditure that has been contracted for but has not been provided for in the financial statements amounts to £327,000 as at 30 June 2011 (2010: £260,000).

### 22 Related party transactions

Other than the Directors and Count on B Ltd, there were no related parties at 30 June 2011 (2010: none).

The Directors considered whether Centrica plc, with its significant commercial activity with the Group and 9.94% shareholding in the Company through GB Gas Holdings Limited, is a related party. As Centrica plc does not take part in financial or operating policy decisions and has no right to appoint a Board member, the Directors considered it does not exert significant influence over the Company and therefore is not a related party.

## Independent Auditors' Report to the Members of Ceres Power Holdings plc

We have audited the parent Company financial statements of Ceres Power Holdings plc for the year ended 30 June 2011 which comprise the Company Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards ('United Kingdom Generally Accepted Accounting Practice').

### Respective responsibilities of Directors and auditors

As explained more fully in the Statement of Directors' responsibilities set out on page 22, the Directors are responsible for the preparation of the parent 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 parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

### Scope of the audit of the financial statements

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 parent 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. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the parent Company financial statements

- give a true and fair view of the state of the Company's affairs as at 30 June 2011,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Directors' Report for the financial year for which the parent Company financial statements are prepared is consistent with the parent Company financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

### Other matter

We have reported separately on the Group financial statements of Ceres Power Holdings plc for the year ended 30 June 2011.

### Rosemary Shapland

#### (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Gatwick  
11 October 2011

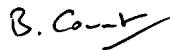
**Company Balance Sheet**

as at 30 June 2011

**Financial  
Statements**

|                                                      | Note | 2011<br>£'000 | 2010<br>£'000 |
|------------------------------------------------------|------|---------------|---------------|
| <b>Fixed assets</b>                                  |      |               |               |
| Investments                                          | 4    | 5,379         | 4,912         |
| <b>Current assets</b>                                |      |               |               |
| Debtors amounts falling due after more than one year | 5    | 1,107         | 25,936        |
| Debtors amounts falling due within one year          | 5    | 89            | 212           |
| Short-term investments                               |      | 20,885        | 34,041        |
| Cash at bank and in hand                             |      | 4,883         | 6,006         |
|                                                      |      | 26,964        | 66,195        |
| <b>Creditors</b> amounts falling due within one year | 6    | (669)         | (248)         |
| <b>Net current assets</b>                            |      | 26,295        | 65,947        |
| <b>Total assets less current liabilities</b>         |      | 31,674        | 70,859        |
| <b>Net assets</b>                                    |      | 31,674        | 70,859        |
| <b>Capital and reserves</b>                          |      |               |               |
| Called up share capital                              | 8    | 4,309         | 4,309         |
| Share premium account                                | 9    | 64,821        | 64,821        |
| Profit and loss account                              | 9    | (37,456)      | 1,729         |
| <b>Total shareholders' funds</b>                     | 10   | 31,674        | 70,859        |

The financial statements on pages 44 to 48 were approved by the Board of Directors on 11 October 2011 and were signed on its behalf by



**Brian Count**  
Chairman



**Rex Ververs**  
Finance Director

Ceres Power Holdings plc  
Registered Number 5174075

# Notes to the Company Financial Statements

for the year ended 30 June 2011

## 1 Accounting policies

These separate financial statements of the Company have been prepared on the going concern basis, under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards in the United Kingdom. A summary of the more important accounting policies, which have been reviewed by the Board of Directors in accordance with Financial Reporting Standard ('FRS') 18, 'Accounting policies', and which have been applied consistently except where noted, is set out below.

### Cash flow statement

The Company has taken advantage of the exemption in FRS 1 (revised 1996), 'Cash Flow Statements', which provides that where a company is a member of a group and a consolidated cash flow statement is published, the Company does not have to prepare a cash flow statement.

### Fixed asset investments

The investment in Ceres Power Limited is accounted for under merger accounting principles and is shown at the nominal value of shares issued as consideration for the undertaking less any amount written off to reflect a permanent diminution in value. The investment in Ceres Intellectual Property Company Limited is stated at cost less any amount written off to reflect a permanent diminution in value.

### Short-term investments

Short-term investments comprise money market funds and bank deposits that are not repayable on demand.

### Amounts owed by Group undertakings

Amounts owed by Group undertakings are recognised and carried at the original invoice amount less an allowance for any uncollectable amounts that is made when the full amount is no longer considered receivable. A provision for impairment of amounts owed by Group undertakings is established based on estimated recoverable amounts.

### Deferred taxation

The Company applies FRS 19, 'Deferred tax', which requires provision to be made in respect of timing differences between the treatment of certain items for accounting and tax purposes. Deferred tax assets are recognised only to the extent that they are regarded as recoverable. Deferred tax assets and liabilities are not discounted.

### Share-based payments

#### Share options

The Group has a number of employee and executive share option and award schemes under which it makes equity-settled share-based payments. The fair value at the date of grant of

equity-settled, share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. The charge is then credited back to reserves.

The fair value of employee share options is calculated using a Black-Scholes or binomial model. In accordance with FRS 20, 'Share-based payment', the resulting cost is charged to the profit and loss account over the vesting periods of the plans. The value of the charge is adjusted to reflect the expected and actual levels of options vesting. FRS 20 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2006 and to all later grants.

Options are granted both to employees of the Company and to employees of the Group. All share-based compensation related to subsidiary employees has been recharged to the subsidiary undertaking by way of a capital contribution to the subsidiary. This capital contribution for the current year has increased investment value by £467,000 (2010: £539,000) with the corresponding credit posted to equity.

### Pension scheme arrangements

The Company operates a defined contribution pension scheme for employees. The assets of the scheme are held separately from those of the Company. The pension costs charged represent contributions paid by the Company to individual pension plans and are charged to the profit and loss account as they become payable.

In addition, a stakeholder pension scheme is also available to employees.

### Research and development expenditure

Expenditure on research and development is written off to the profit and loss account as incurred.

### Related party transactions

The Company has taken advantage of the exemption available to parent companies under FRS 8, 'Related Party Disclosures', not to disclose transactions and balances with wholly owned subsidiaries.

## 2. Loss for the year

The Company has taken advantage of the exemption available under section 408 of the Companies Act 2006 and has not presented its profit and loss account. The Company's result for the year was a loss of £39,797,000 (2010: loss of £539,000). The loss for the year includes a £39 million provision against amounts owing to the Company by Ceres Power Limited.

## Notes to the Company Financial Statements

for the year ended 30 June 2011 continued

## Financial Statements

### 3 Employees and Directors

The average monthly number of persons (including Executive Directors) employed by the Company during the year was

|                    | 2011<br>Number | 2010<br>Number |
|--------------------|----------------|----------------|
| <b>By activity</b> |                |                |
| Administration     | 1              | 1              |
|                    | 1              | 1              |

The only employee of the Company during the year was also a Director of the Company

|                                                               | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------------------------|---------------|---------------|
| <b>Staff costs (for the above persons):</b>                   |               |               |
| Wages and salaries, including compensation for loss of office | 473           | 197           |
| Social security costs                                         | 50            | 25            |
| Other pension costs                                           | 17            | 17            |
| Share-based payments                                          | 146           | 173           |
|                                                               | 686           | 412           |

For further information on Directors' emoluments, see the Remuneration Report on pages 16 to 20

### 4 Fixed asset investments

In subsidiary companies

|                                                                      | 2011<br>£'000 | 2010<br>£'000 |
|----------------------------------------------------------------------|---------------|---------------|
| Cost and net book value                                              |               |               |
| At 1 July                                                            | 4,912         | 4,373         |
| Capital contributions arising from FRS 20 share-based payment charge | 467           | 539           |
| <b>At 30 June</b>                                                    | <b>5,379</b>  | <b>4,912</b>  |

The capital contributions arising from the FRS 20 share-based payment charge are due to the Company granting share options to the employees of Ceres Power Limited

The Company's investments comprise interests in Group undertakings, details of which are shown below

| Name of undertaking                         | Country of incorporation | Description of shares held | Proportion of nominal value of shares held by the Company |
|---------------------------------------------|--------------------------|----------------------------|-----------------------------------------------------------|
| Ceres Power Limited                         | England and Wales        | £0.001 ordinary shares     | 100%                                                      |
| Ceres Intellectual Property Company Limited | England and Wales        | £1.00 ordinary share       | 100%                                                      |

The principal activity of Ceres Power Limited is the development and commercial exploitation of microgeneration products based on solid oxide fuel cell technology. The principal activity of Ceres Intellectual Property Company Limited is the administration of registered intellectual property developed within the Group. The results of Ceres Power Limited and Ceres Intellectual Property Company Limited are included within the consolidated financial statements.

**5 Debtors**

|                                                      | 2011<br>£'000 | 2010<br>£'000 |
|------------------------------------------------------|---------------|---------------|
| <b>Amounts falling due within one year</b>           |               |               |
| Other debtors                                        | 6             | 4             |
| Prepayments and accrued income                       | 83            | 208           |
|                                                      | <b>89</b>     | <b>212</b>    |
| <b>Amounts falling due after more than one year:</b> |               |               |
| Amounts owed by Group undertakings                   | 1,107         | 25,936        |
|                                                      | <b>1,196</b>  | <b>26,148</b> |

The amounts owed by Group undertakings comprise inter-company loans and recharges. No specific repayment or interest terms are associated with these amounts. As of 30 June 2011, a provision of £39,006,000 has been made against the inter-company loan to Ceres Power Limited (2010: £nil), reflecting management's best estimate of the recoverable amount.

A subordination agreement exists between the Company and Ceres Power Limited. Amounts owed by Ceres Power Limited to the Company (£39,006,000) are subordinated to all other creditors of Ceres Power Limited (2010: £25,051,000).

**6 Creditors amounts falling due within one year**

|                              | 2011<br>£'000 | 2010<br>£'000 |
|------------------------------|---------------|---------------|
| Trade creditors              | 22            | 19            |
| Taxation and social security | 175           | 29            |
| Other creditors              | 96            | -             |
| Accruals and deferred income | 376           | 200           |
|                              | <b>669</b>    | <b>248</b>    |

**7 Provisions for liabilities and charges****Deferred taxation**

Potential deferred tax assets have not been recognised but are set out below

|                                                    | 2011<br>£'000 | 2010<br>£'000 |
|----------------------------------------------------|---------------|---------------|
| <b>Tax effect of timing differences because of</b> |               |               |
| Deductions relating to share options               | (36)          | (559)         |
| Losses carried forward                             | (578)         | (430)         |
|                                                    | <b>(614)</b>  | <b>(989)</b>  |

The deferred tax assets have not been recognised as the Directors consider that it is unlikely that the asset will be realised in the foreseeable future.

**8 Called up share capital**

|                                | 2011        |       | 2010        |       |
|--------------------------------|-------------|-------|-------------|-------|
|                                | Number      | £'000 | Number      | £'000 |
| <b>Authorised</b>              |             |       |             |       |
| Ordinary shares of £0.05 each  | 100,000,000 | 5,000 | 100,000,000 | 5,000 |
| <b>Allotted and fully paid</b> |             |       |             |       |
| Ordinary shares of £0.05 each  | 86,177,614  | 4,309 | 86,177,614  | 4,309 |

Details of shares issued in the period are provided in note 16 to the Group financial statements. Details of share options are disclosed in note 17 to the Group financial statements.

## Financial Statements

### Notes to the Company Financial Statements

for the year ended 30 June 2011 continued

#### 9 Reserves

|                             | Share<br>premium<br>account<br>£ 000 | Profit<br>and loss<br>account<br>£ 000 |
|-----------------------------|--------------------------------------|----------------------------------------|
| At 1 July 2010              | 64,821                               | 1,729                                  |
| Loss for the financial year | –                                    | (39,797)                               |
| Share-based payments charge | –                                    | 612                                    |
| <b>At 30 June 2011</b>      | <b>64,821</b>                        | <b>(37,456)</b>                        |

#### 10 Reconciliation of movements in shareholders' funds

|                                             | 2011<br>£'000   | 2010<br>£ 000 |
|---------------------------------------------|-----------------|---------------|
| Loss for the financial year                 | (39,797)        | (539)         |
| Proceeds of issue of ordinary share capital | –               | 31,556        |
| Share issue costs                           | –               | (1,321)       |
| Share-based payments charge                 | 612             | 712           |
| <b>Net change in shareholders' funds</b>    | <b>(39,185)</b> | <b>30,408</b> |
| Opening shareholders' funds                 | <b>70,859</b>   | <b>40,451</b> |
| <b>Closing shareholders' funds</b>          | <b>31,674</b>   | <b>70,859</b> |

## Directors and Advisors

### Directors

Dr Brian Count (Non-Executive Chairman)<sup>1</sup>  
David Pummell (Chief Executive Officer)<sup>1 2</sup>  
Rex Vevers (Finance Director)<sup>1 2</sup>  
Dr Phil Whalen (Technology Director)<sup>1 2</sup>  
Bob Flint (Commercial Director)<sup>2</sup>  
Jonathan Watkins (Operations Director)<sup>2</sup>  
Sir David Brown (Non-Executive Senior Independent Director)<sup>1</sup>  
Alan Wood (Non-Executive Director)<sup>1</sup>  
John Nicholas (Non-Executive Director)<sup>1</sup>

1 Ceres Power Holdings plc  
2 Ceres Power Limited

**Company Secretary**  
Richard Preston

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Chartered Accountants and Statutory Auditors  
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**Registered number**  
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