Company Registration No. 5059407

# ITM POWER PLC

## Report and Financial Statements

## Year ended 30 April 2006



28/07/06
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# ITM POWER PLC

## REPORT AND FINANCIAL STATEMENTS 2006

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# ITM POWER PLC

## REPORT AND FINANCIAL STATEMENTS 2006

## OFFICERS AND PROFESSIONAL ADVISERS

### DIRECTORS

S Massey
F J Heathcote
D J Highgate
J A Lloyd
P Hargreaves
Lord Peter Walker
Roger Putnam

### REGISTRARS

Capita IRG PLC
The Registry
34 Beckenham Road
Beckenham BR3 4TU

### SECRETARY

M J Scott

### REGISTERED OFFICE

Orkney House,
Great Chesterford Court
Great Chesterford
Saffron Walden CB10 1PF

### NOMINATED ADVISOR AND BROKER

Panmure Gordon & Co
Moorgate Hall
155 Moorgate
London EC2M 6XB

### BANKERS

National Westminster Bank plc
Stamford Branch
52 High Street
Stamford
Lincolnshire PE9 2BD

### SOLICITORS

Burges Salmon LLP
Narrow Quay House
Narrow Quay
Bristol BS1 4AH

### AUDITORS

Deloitte & Touche LLP
Chartered Accountants
Cambridge

### PRESS AND INVESTOR ENQUIRIES

Gemma Chandler
Corporate Communications Officer
ITM Power PLC
Tel: 01799 532 860
Mob: 07921 057712

## CHAIRMAN'S STATEMENT

## HIGHLIGHTS

- Successfully completed all milestones set out at the time of the IPO - achieved earlier than expected
- Successfully tested its low cost membrane technology in excess of 3,500 hours of operation without evidence of degradation. ITM's membrane technology has now reached 5,000 hours of operation without evidence of degradation
- Costs further reduced with the elimination of high cost platinum catalysts
- Principal patents granted and IP Portfolio increased
- New demonstration facility at Sheffield laboratories
- Raised £29.4 million through placing of ordinary shares with institutional investors in May 2006
- Loss for the year increased from £1.2m to £1.9m in line with budget
- Capital expenditure increased due to the additional test equipment and expansion to our laboratories in Sheffield
- New development programme initiated to develop an electrolyser refuelling system for use in bi-fuel hydrogen-petrol internal combustion engine powered cars
- New objectives introduced in addition to milestones set out in January 2006
- Appointment of new non executive director and electrolyser business development officer

Stephen Massey, Chairman commented: "*Over the past two years, we have built a solid foundation as a platform to underpin the route to commercialisation. We remain on track to achieve the first of our new technical milestones by October 2006 and we will continue to progress with development plans within our target markets. We also hope to announce further results on our hydrogen technologies and remain focused with increasing emphasis on the commercialisation of ITM's technology. I am confident that ITM is in a strong position to achieve its business objectives through strong science, people and finances.*"

# CHAIRMAN'S STATEMENT

I am pleased to report the full year results for the year ended 30 April 2006. On behalf of the Board, I would like to thank our existing shareholders for their continued support and welcome the new shareholders resulting from the placing in May 2006.

**World Energy Review**

Over the past year, concern about the ability of oil and other fossil fuels to meet our increasing energy demands has doubled. In addition, evidence that fossil fuels are perceived to be altering the global climate through greenhouse gas emissions has also been widely recognised.

ITM believes that there is no primary energy shortage, but there is a technology gap. The amount of energy mankind consumes in a day is roughly equivalent to 10 seconds of sunlight hitting at the earth. In fact, renewable energy, which includes wind, wave solar and hydro, is so abundant that it far exceeds our capabilities to effectively use it. Historically, this enormous amount of renewable energy has not been utilised because there has been no economic system for converting it into a storable fuel. The solution lies in the development of a cost effective sustainable energy system. To achieve this, issues of performance, capital cost, running costs, efficiency and disposal costs all need to be considered. Efficiency alone is not sufficient and we believe our technology offers an overall cost effective and practical solution to these issues.

**Financials**

The loss for the year increased from £1.2m to £1.9m, in line with budget. Capital expenditure increased due to the additional test equipment and expansion to our laboratories in Sheffield. Additionally, we have strengthened the scientific and technical team at our laboratories as well as strengthening our management and corporate team at our head office in Cambridge.

At the year end, the company held cash at the bank and on deposits of £5.4m. Subsequent to year end, the company raised £29.4m through placing of ordinary shares with institutional investors. The strengthened balance sheet enables ITM to take the next steps on the road to commercialisation through developing larger prototypes, conducting field trials, establishing agreements with complementary third parties, while protecting the company's intellectual property.

ITM maintained tight control over cash expenditures during the year in review and we will continue to monitor budgets carefully. Our costs will gradually increase over the next year to support accelerated development and engineering activity.

The Board is not recommending payment of a dividend in accordance to the dividend policy stated at the time of the IPO.

**Review**

I am pleased to report that during the year in review, ITM Power has successfully completed all the milestones set out at the time of the IPO; these were achieved earlier than expected. The major focus of our work was to determine the cost and durability of electrolysers prior to embarking on commercial negotiations. This was in order to assess commercial viability and to file patents on the additional IP necessary to protect our core technologies. ITM successfully tested its low cost membrane technology in excess of 3,500 hours of operation without evidence of degradation. Since the end of the financial year we have surpassed 5,000 hours without degradation. Furthermore, to add to these successes, ITM has further reduced costs with the elimination of high cost platinum catalysts. Given low cost input electricity, these combined technological advances can enable electrolysers to produce hydrogen cost competitively with petrol in Europe. We are reviewing the best available hydrogen storage systems that are compatible with our electrolysers.

During the past two years, ITM has devoted considerable effort to its electrolyser programme, because it has become apparent to the company that the absence of a low cost, durable electrolyser is a major obstacle to the implementation of a sustainable energy system. Electrolysers could simultaneously address the availability and cost of hydrogen fuel as well as the infrastructure that will enable the adoption of fuel cells.

## CHAIRMAN'S STATEMENT

Other significant research and development achievements arising during the year in review includes:

- In September 2005, the European Patent Office formally allowed ITM's core patent application on electrochemical cells using hydrophilic polymers and the patents were granted on 21 December 2005. The application covers both low cost materials and novel manufacturing processes used separately or in a combination to produce membrane electrode assemblies for use in fuel cells and electrolysers. The core patent has also been granted in Australia, Eurasia and South Africa.

  We have also increased our IP portfolio through 1 new patent granted and 7 new patents filed. We have a total of 19 active patent applications.

- In November 2005, ITM announced it had filed patent applications on both the invention of a composite membrane with enhanced properties (including specifically an acid / alkaline laminate) and on the use of control grids to act directly and control the electrical activity within a fuel cell. This technology has the potential to improve the efficiency of both fuel cells and electrolysers and offers a unique route to controlling the output from fuel cells. Research on the composite membranes continues to yield encouraging results.

- In April 2005, the BOC Foundation awarded ITM Power a grant and assisted in the establishment of a high-level expert research committee to investigate the application of the company's electrolyser technology to optimise the capture and use of renewable energy sources such as wind and solar power. Both parties are pleased to continue the collaboration for a further year with the objective of continuing the work of defining test and evaluation procedures.

- In October 2005, ITM announced that it had concluded an agreement with Heriot Watt University to fund research on the production of tertiary hydrocarbons by combining electrolytic hydrogen from renewable sources and carbon dioxide recovered from the atmosphere. Initial results indicated that it was possible to create hydrocarbons having molecular weights significantly greater than alcohol. ITM filed a patent application covering the use of 'renewable' hydrogen and 'waste' carbon dioxide to permanently sequester carbon dioxide in commercially valuable products e.g. bitumen. Preliminary results on the production of liquid hydrocarbons using electrolytic hydrogen appear very encouraging.

- In April 2006, ITM built a demonstration facility at its Sheffield premises in which its electrolyser technology is used to convert renewable electricity into clean (carbon free) hydrogen. The hydrogen is stored and reconverted into:

(a) Low voltage electricity using an ITM fuel cell equipped with a proprietary ITM electronic controller as would typically be required to drive electronic equipment. A DVD player is used in our demonstration.

(b) Mains voltage electricity using a generator (modified by ITM to run on hydrogen) which is demonstrated powering lighting, heating and refrigeration equipment and small electric motors.

(c) Heat using a commercially available gas hob (modified by ITM to run on hydrogen).

(d) Refrigeration using a commercially available gas fridge modified by ITM.

These demonstrations represent a firm basis for seeking commercially viable applications of ITM's technology because the relevant equipment is already well established and in many cases is available 'off the shelf'.

## CHAIRMAN'S STATEMENT

**Recent developments**

As the scientific work continues, we are also moving into the engineering and development phase to produce devices suitable for field trial testing. ITM's initial focus is to establish market led relationships that link energy producers with consumers. We will work either independently or in third party collaborations to develop prototypes and conduct field trials in preparation for commercialisation. We intend to continue to expand and protect our intellectual property base, including a growing portfolio of trade marks and designs. Our objective is to maximise income potential by controlling key processes and important aspects of the storage and use of sustainable energy.

Since the year end, we have initiated a development programme in one of our target markets. ITM announced on 5 July 2006 it had agreed to commission The University of Hertfordshire to develop a refuelling system for bi-fuel hydrogen-petrol internal combustion engine powered cars. A low cost ITM electrolyser will be applied to provide the hydrogen refuelling system. The vehicle will be able to operate using hydrogen before automatically switching to petrol. Half of all cars in the USA travel only 25 miles a day (Source: Scientific American, April 2006), for that reason, we have decided to set a range of 25 miles running on hydrogen as an initial objective for the vehicle.

In addition to our commercial plans we have expanded the scope of our work and have introduced new objectives in addition to those milestones set out in January 2006.

*Milestones set out in January 2006:*

- Electrolyser: a 5kW electrolyser stack for delivery by December 2006 (designed for assembly into 20kW modules)
- Electrolyser a 25kW electrolyser stack for delivery by December 2007 (designed for assembly into 100kW modules)
- Fuel Cell: a 4W fuel cell prototype module together with the rapid refueling cartridge and output power conditioning electronics necessary to operate electronic devices by December 2006
- Fuel Cell: a 20W, 2-liquid fuel cell stack engineered to
    - pre-production standard, including fuel supply cassette
    - and interface electronics, by December 2007
- Production Process *the development of 'production ready' cell modules* made
    - by a fully engineered 'one-step' production route for delivery by December 2007

## CHAIRMAN'S STATEMENT

Additional objectives now include:

*Pressure*

Hydrogen storage will always be an issue due to the large volumes of gas needed to compete with liquid fuels. Increasing the pressure of a gas reduces its volume. I am pleased to report that we have begun testing our electrolysers with the initial objective of achieving an electrolyser operating pressure of 75 bar by the end of 2007. This would be compatible with gas mains pressure. ITM's objective is to achieve this in the following stages:

| Objective date | Target Pressure |
| --- | --- |
| December 2006 | 20 bar |
| June 2007 | 50 bar |
| December 2007 | 75 bar |

*Fuel cells*

It has always been the belief of ITM that unless hydrogen fuel was readily available, the adoption of solid polymer fuel cells would be severely limited. Following the success of our electrolyser programme, we now propose to apply the same design philosophy to fuel cells. We have begun development work using our low cost materials and processes with the objective of developing low cost and durable hydrogen / oxygen fuel cells. The availability of a low cost electrolyser and low cost fuel cell will represent a valuable commercial opportunity.

The 250W hydrogen/oxygen fuel cell that was completed in December 2005 (as a part of the IPO milestone objectives set in June 2004) achieved a power density of 160mW/cm2. On the basis of this power density this device was costed at approximately $2,000/kW which was considered to be uncompetitive.

Fuel cell capital costs can be reduced by a number of routes including increased power density. We now plan to demonstrate fuel cell operation with a power density of 360mW/cm2 by the end of October 2006. The technology which will be developed in this fuel cell programme will be costed on the basis of production volumes for a 10kW device, but only demonstrated in smaller devices between 100W and 500W. The October 2006 device will reflect an equivalent cost of $900/kW.

Our future objectives are to apply the wide range of technological options available to ITM to achieve high power production devices with the following cost base:

| Objective date | Target Device Costing ($/kW) |
| --- | --- |
| December 2006 | 700 |
| June 2007 | 500 |
| December 2007 | 250 |

**Board and Staff**

In August 2005, Gervas Steele resigned from the Board as a non-executive director to pursue other business interests. In January 2006, John Wreford retired from the Board as Finance Director. Marcus Scott joined ITM in November 2005 as Chief Financial Officer to undertake the financial planning and company Secretariat duties of the company.

I am delighted to welcome Roger Putnam to the Board as non executive director. Roger joined the Board on 15 May 2006. He is the former Chairman of Ford of Britain, and currently President of the Society of Motor Manufacturers and Traders and a member of the Government's Energy Review Partnership. Roger's wealth of experience in management, sales and marketing within global businesses and his relationships within government and industry is already proving invaluable to ITM.

I am also delighted to welcome Professor Marcus Newborough to the company. Marcus was appointed after the period in review, as Electrolyser Business Development Officer. Marcus's experience and skill in interfacing

## CHAIRMAN'S STATEMENT

between multiple energy systems and electrolysers will be invaluable in the strategic planning and commercialisation of ITM's electrolyser technology.

We are currently recruiting and strengthening the technical team in Sheffield and building a new commercial team in Cambridge.

I would like to take this opportunity to welcome the new members of staff to ITM and thank all our staff for their hard work during the year.

**Outlook**

Over the past two years, we have built a solid foundation as a platform to underpin the route to commercialisation. We remain on track to achieve the first of our new technical milestones by October 2006 and we will continue to progress with development plans within our target markets. We also hope to announce further results on our hydrogen technologies and remain focused with increasing emphasis on the commercialisation of ITM's technology. I am confident that ITM is in a strong position to achieve its business objectives through strong science, people and finances.

Stephen Massey
Chairman
31 July 2006

## BOARD OF DIRECTORS

**S Massey, Non-executive Chairman (age 48)**

Stephen joined ITM Power in February 2004, prior to which he was Chairman and CEO of Prudential-Bache International Ltd, a subsidiary of Prudential Securities Group Inc, of which he was also a director. He is also a founding director of Harvington Properties Ltd and is currently Chairman of Eden Group Plc; a City based financial services organization. He has a degree in Politics, Philosophy and Economics from Oxford University.

**F J Heathcote, Chief Executive Officer (age 49)**

Jim joined the Board of ITM as a non-executive director in March 2002 and was appointed Chief Executive Officer in May 2003. He is a chartered accountant with extensive experience of global capital markets and the hydrogen economy. He was a Senior Vice President of Drexel Burnham Lambert and Executive Vice President of Prudential-Bache Securities (U.K.) Inc. before moving into fund management and founding the Katalyst Hydrogen Fund. The fund specialised in investments in hydrogen technologies.

**D J Highgate, Director of Research (age 65)**

ITM's Director of Research, Dr Donald Highgate, has a background in hydrophilic polymer chemistry. In 1995, he spotted an opportunity to use his experience to develop a new class of low-cost membrane polymers, which are at the heart of a PEM fuel cell. This enabled him to simplify fuel cell architecture by devising an in situ manufacturing process, using the new polymers, with the potential to significantly reduce the costs of fuel cell - and electrolyser - mass production.

**J A Lloyd, Engineering Director (age 59)**

Jonathan is co-founder of ITM and serves as Engineering Director. He is a mechanical engineer with considerable industrial and consultancy experience with Babcock, Vickers and Perkins Engines. In 1995 he began collaborating with Dr Highgate at Cranfield University. He is now responsible for the engineering development of hydrophilic polymer applications. As Engineering Director he will continue to be responsible for design and prototype production, including liaising with academic institutions where he has a number of contacts.

**P Hargreaves, Non-executive director (age 59)**

Peter joined the Board of ITM in February 2004 as a non-executive director. After qualifying as a chartered accountant he was employed by KPMG, Unisys and Whitbread and Company Limited. In 1981 he founded the national investment brokerage Hargreaves Lansdown PLC where he remains as Chief Executive Officer.

**Lord Peter Walker, Non-executive director (age 74)**

Lord Walker was a member of all Conservative Cabinets between 1970 and 1990, holding several posts including Secretary of State for Trade and Industry (including Energy), Secretary of State for the Environment and Secretary of State for Energy. He is currently Chairman of Allianz Cornhill Insurance plc and a non-executive director of The London International Financial Futures and Options Exchange. After retiring from the Cabinet, Lord Walker became Chairman of international investment bank, Kleinwort Benson Group plc and is now Vice Chairman of Dresdner Kleinwort Wasserstein.

**R Putnam, Non-executive director (age 60)**

Roger Putnam, the former Chairman of Ford of Britain, is currently President of the Society of Motor Manufacturers and Traders and a member of the Government's Energy Review Partnership. The Partnership will report to the Chancellor on the country's future energy strategy. Other directorships include: Chairman of Jaguar Daimler Heritage Trust, the DTI's Retail Motor Strategy Group and Deputy Chairman of Motorsport Development UK. He is also a visiting professor of Automotive Studies at the City of London University. Roger's distinguished career in the automotive industry began at Lotus Plc. In 1982 he joined Jaguar Cars Ltd as director, marketing and UK sales operations. In 1985 Roger was appointed to the board of Jaguar as Director, Sales and Marketing, a role he retained until he was appointed Chairman of Ford of Britain in 2002. Roger was appointed to the Board on 15 May 2006.

# DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended 30 April 2006.

## PRINCIPAL ACTIVITIES

The principal activity of the group is the research and development of scientific and engineering projects.

## REVIEW OF DEVELOPMENTS AND FUTURE PROSPECTS

The group has continued with the development of materials and manufacturing methods for fuel cells and electrolysers. Further patents have been filed and new laboratory and workshop premises were extended in Sheffield for the purposes of expanding the research and development activities. For further detail on the development and future prospects of the group refer to the Chairman's statement.

## RESEARCH AND DEVELOPMENT

During the year the group incurred research and development related costs of £1,608,044 (2005 - £930,525).

## PRINCIPAL RISKS AND UNCERTAINTIES

A full appraisal of the technological risks faced by the group and discussion of the group's progress against technological milestones has been included in the Chairman's statement.

The group's activities expose it to a number of financial risks including interest rate risk, cash flow risk and liquidity risk. The use of financial derivatives is governed by the group's policies approved by the board of directors, which provide written principles on the use of financial derivatives to manage these risks. The group does not use derivative financial instruments for speculative purposes.

### Interest rate risk

The group financial assets include sterling cash deposits and cash at bank and in hand which are part of the financing arrangements of the group. The sterling cash deposits comprise amounts placed on deposit at fixed interest rates for periods of up to one year and at call. The group seeks to maximise interest receipts within these parameters. Interest receipts are earned on deposits at the prevailing rate. The group's policy throughout the periods presented has been to minimise the risk by placing funds in low risk cash deposits but to also maximise the return on funds placed on deposit.

### Cash flow risk

Interest bearing assets and liabilities are held at fixed rate to ensure certainty of cash flows.

### Liquidity risk

In order to maintain liquidity to ensure that sufficient funds are available for ongoing operations and future developments, the group uses equity finance.

## DIVIDENDS

The directors do not recommend the payment of a dividend (2005 - £nil).

## DIRECTORS' REPORT (continued)

### DIRECTORS AND THEIR INTERESTS

The directors who served during the year and their interests in the shares of ITM Power plc were as follows.

| | Ordinary shares of 5p each At 30 April 2006 No | Ordinary shares of 5p each At 30 April 2005 No |
|---|---|---|
| S Massey (Chairman) | 100,000 | 100,000 |
| F J Heathcote | 1,412,500 | 1,412,500 |
| J A D Wreford (resigned 31 January 2006) | 10,136,363 | 14,000,000 |
| D J Highgate | 12,522,728 | 14,000,000 |
| J A Lloyd | 12,522,728 | 14,000,000 |
| P Hargreaves | 5,245,810 | 5,045,810 |
| C G A Steele (resigned 25 August 2005) | 568,250 | 1,356,250 |
| Lord Peter Walker | 120,000 | 120,000 |

R Putnam was appointed a director on 15 May 2006.

Subsequent to the year end, J A D Wreford sold 3,250,000 ordinary shares on 11 May 2006. In addition, P Hargreaves purchased a further 100,000 ordinary shares on 23 May 2006.

The following options have been granted to directors over ordinary shares in the company:

| | Number of shares of 5p each At 30 April 2006 | Number of shares of 5p each At 30 April 2005 |
|---|---|---|
| S Massey (Chairman) | 700,000 | 700,000 |
| F J Heathcote | 7,409,500 | 7,409,500 |
| D J Highgate | - | - |
| J A Lloyd | - | - |
| P Hargreaves | - | - |
| Lord Peter Walker | 400,000 | 400,000 |

### SUBSTANTIAL SHAREHOLDINGS

As at 27 July 2006 the following interests of 3% or more in the issued share capital of the company appears in the register maintained under the provisions of Section 211 of the Companies Act 1995.

| | Number of shares | % of issued |
|---|---|---|
| J A Lloyd | 12,522,728 | 12.38% |
| D J Highgate | 12,522,728 | 12.38% |
| J A D Wreford | 6,886,363 | 6.81% |
| Fidelity | 5,971,764 | 5.90% |
| P Hargreaves | 5,345,810 | 5.28% |
| | 43,249,393 | 42.75% |

### SUPPLIER PAYMENT POLICY

The company and group's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the group at 30 April 2006 were equivalent to 30 (2005 - 18) days' purchases, based on the average daily amount invoiced by suppliers during the year.

## DIRECTORS' REPORT (continued)

### POLITICAL AND CHARITABLE CONTRIBUTIONS

There were no political or charitable contributions in the year (2005 - nil).

### AUDITORS

In the case of each of the persons who are directors of the company at the date when this report is approved:

- so far as each of the directors is aware, there is no relevant audit information (as defined in the Companies Act 1985) of which the company's auditors are unaware; and
- each of the directors has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information (as defined) and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Approved by the Board
*and signed on its behalf by:*

F J Heathcote

Director

# CORPORATE GOVERNANCE REPORT

***Combined code***

The directors acknowledge the importance of the principles of corporate governance contained in the Combined Code on Corporate Governance which is appended to the Listing Rules of The Financial Services Authority ("The 2003 FRC Code"), and intend, in so far as practicable given the company's size and the constitution of the Board, to comply with the main provisions of the Combined Code.

The directors intend to comply with Rule 21 of the AIM Rules relating to directors' dealings as applicable to AIM companies and will also take all reasonable steps to ensure compliance by the group's applicable employees.

**The Board of Directors and Board Committees**

At 30 April 2006 the Board comprised a Non Executive Chairman, Chief Executive Officer, two further executive directors and two further non-executive directors. The directors have established the following committees:

**The Remuneration Committee** comprised Stephen Massey as Chairman, Lord Walker and Peter Hargreaves. It determines the terms and conditions of service, the remuneration and grant of options to executive directors under the EMI scheme adopted by the company.

**The Audit Committee** comprised Peter Hargreaves as Chairman and Lord Walker. It has primary responsibility for monitoring the quality of internal control, ensuring that the financial performance of the company is properly measured and reported on and for reviewing reports from the company's auditors relating to its accounting and internal controls in all cases having due regard to the interests of the shareholders.

**The Nominations Committee** comprised Stephen Massey as Chairman, Peter Hargreaves and Dr Donald Highgate. It vets and presents to the Board potential new directors, particularly non-executives.

**The Executive Committee** comprised Jim Heathcote, Dr Donald Highgate and Dr Jon Lloyd. It meets regularly to consider business development, management issues, and financial performance of the group.

**Annual Review of Board**

The Chairman will undertake a review of how the Board is functioning. A committee lead by Lord Walker, which includes the other non-executive directors as members, will appraise the Chairman.

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report and the financial statements. The directors have chosen to prepare the accounts for the group in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

United Kingdom company law requires the directors to prepare such financial statements for each financial year which give a true and fair view in accordance with UK GAAP of the state of affairs of the company and the group and of the profit or loss of the group for that period and comply with UK GAAP and the Companies Act 1985. In preparing those financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and the group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ITM POWER PLC

We have audited the group and individual company financial statements (the "financial statements") of ITM Power plc for the year ended 30 April 2006 which comprise the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement and the related notes 1 to 22. These financial statements have been prepared under the accounting policies set out therein.

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

**Respective responsibilities of directors and auditors**

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

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

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

We read the information contained in the annual report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the company and the group, consistently applied and adequately disclosed.

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

**Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the individual company's affairs as at 30 April 2006 and of the group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Deloitte & Touche LLP

**Deloitte & Touche LLP**
Chartered Accountants and Registered Auditors
Cambridge

United Kingdom

31 July 2006

## CONSOLIDATED PROFIT AND LOSS ACCOUNT
## Year ended 30 April 2006

| | | Note | 2006 £ | 2005 £ |
|---|---|---|---|---|
| Administrative expenses | - research and development | | (1,608,044) | (930,525) |
| | - share option charges | | - | (175,000) |
| | - other | | (901,462) | (745,938) |
| | | | (2,509,506) | (1,851,463) |
| Other operating income | | | 361,678 | 241,306 |
| **OPERATING LOSS** | | | (2,147,828) | (1,610,157) |
| Interest receivable - bank interest | | | 290,212 | 346,461 |
| **LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION** | | 3 | (1,857,616) | (1,263,696) |
| Tax on loss on ordinary activities | | 5 | 208 | 58,108 |
| **LOSS FOR THE FINANCIAL YEAR** | | 13 | (1,857,408) | (1,205,588) |
| **LOSS PER ORDINARY SHARE** | | | | |
| Basic and diluted | | 7 | (2.0p) | (1.3p) |

All activities derive from continuing operations.

There are no recognised gains or losses for the current financial year or preceding financial year other than as stated above. Therefore no statement of total recognised gains and losses are presented in these financial statements.

## CONSOLIDATED BALANCE SHEET
## 30 April 2006

| | Note | 2006 £ | 2005 £ |
|---|---|---|---|
| **FIXED ASSETS** | | | |
| Tangible assets | 9 | 827,402 | 396,481 |
| **CURRENT ASSETS** | | | |
| Debtors | 10 | 594,203 | 464,500 |
| Investments - cash on deposit | | 5,400,000 | 7,550,000 |
| Cash at bank and in hand | | 62,564 | 193,469 |
| | | 6,056,767 | 8,207,969 |
| **CREDITORS: amounts falling due within one year** | 11 | (293,440) | (161,799) |
| **NET CURRENT ASSETS** | | 5,763,327 | 8,046,170 |
| **TOTAL ASSETS LESS CURRENT LIABILITIES, BEING NET ASSETS** | | 6,590,729 | 8,442,651 |
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 12 | 4,598,513 | 4,593,713 |
| Share premium account | 13 | 8,103,536 | 8,102,850 |
| Merger reserve | 13 | (1,972,820) | (1,972,820) |
| Profit and loss account | 13 | (4,138,500) | (2,281,092) |
| **EQUITY SHAREHOLDERS' FUNDS** | 14 | 6,590,729 | 8,442,651 |

These financial statements were approved by the Board of Directors on 28th July 2006

Signed on behalf of the Board of Directors

F. J. Heathcote

F J Heathcote

Director

# BALANCE SHEET
## 30 April 2006

| | Note | 2006 £ | 2005 £ |
|---|---|---|---|
| **FIXED ASSETS** | | | |
| Investments | 8 | 3,570,000 | 3,570,000 |
| **CURRENT ASSETS** | | | |
| Debtors | 10 | 3,627,688 | 2,135,381 |
| Investments - cash on deposit | | 5,400,000 | 6,700,000 |
| Cash at bank and in hand | | 62,461 | 87,237 |
| | | 9,090,149 | 8,922,618 |
| **CREDITORS: amounts falling due within one year** | 11 | (39,896) | (25,106) |
| **NET CURRENT ASSETS** | | 9,050,253 | 8,897,512 |
| **TOTAL ASSETS LESS CURRENT LIABILITIES, BEING NET ASSETS** | | 12,620,253 | 12,467,512 |
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 12 | 4,598,513 | 4,593,713 |
| Share premium account | 13 | 8,103,536 | 8,102,850 |
| Profit and loss account | 13 | (81,796) | (229,051) |
| **EQUITY SHAREHOLDERS' FUNDS** | | 12,620,253 | 12,467,512 |

These financial statements were approved by the Board of Directors on 28th July 2006

Signed on behalf of the Board of Directors

F J Heathcote

Director

## CONSOLIDATED CASH FLOW STATEMENT
## Year ended 30 April 2006

| | Note | 2006<br>£ | 2005<br>£ |
|---|---|---|---|
| **Net cash outflow from operating activities** | 16 | (1,910,873) | (1,355,823) |
| **Returns on investments and servicing of finance** | 17 | 189,832 | 121,503 |
| **Taxation** | 17 | 58,316 | 43,555 |
| **Capital expenditure and financial investment** | 17 | (641,660) | (383,212) |
| **Net cash outflow before management of liquid resources and financing** | | (2,304,385) | (1,573,977) |
| **Management of liquid resources** | 17 | 2,150,000 | (7,274,524) |
| **Financing** | 17 | 5,486 | 9,126,563 |
| **(Decrease) increase in cash** | 18 | (148,899) | 278,062 |

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 1. ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable United Kingdom accounting standards. The particular accounting policies adopted are described below.

**Accounting convention**

The financial statements are prepared under the historical cost convention.

**Basis of consolidation**

The group financial statements consolidate the accounts of the company and its subsidiary undertaking drawn up to 30 April each year.

**Tangible fixed assets**

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment.

Depreciation is provided at rates calculated to write off the cost of fixed assets, less their estimated residual value, over their expected useful lives on the following bases:

| | |
|---|---|
| Laboratory and test equipment | 4 years straight line |
| Computer equipment | 3 years straight line |
| Office furniture and fittings | 4 years straight line |

Residual value is calculated on prices prevailing at the date of acquisition.

Leasehold improvements are capitalised and written off over the period of the lease.

**Investments**

These are stated at cost less a provision for any permanent impairment in value.

**Foreign currency**

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the profit and loss account.

**Taxation**

Current tax is provided at amounts expected to be paid or recovered, using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in full on timing differences, which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

**Leases**

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis.

**Share option charges**

In accordance with UITF 17, the group recognises a charge on share options issued at below fair value, equal to the differential between the fair value and exercise price of the option on the date of grant.

**Research and development**

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

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

1. **ACCOUNTING POLICIES (continued)**

**Pension costs**

The company operates a defined contribution pension scheme. The amount charged to the profit and loss account in respect of pension costs is the contributions actually payable in the year. Differences between contributions payable and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

**Grants**

Government and other grants are included in other operating income in the period in which the expenditure they relate to is incurred. Government grants to date have been to fund operating expenditure relating to specific research projects.

2. **SEGMENTAL INFORMATION**

There is only one class of business, which is the research and development of scientific and engineering projects.

The analysis of operating loss, loss before taxation and the net assets of the group by geographical segment have not been provided due to the fact that there is only one geographical location, being the United Kingdom.

3. **LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION**

| | | 2006 £ | 2005 £ |
|---|---|---|---|
| **Loss on ordinary activities before taxation is stated after charging (crediting):** | | | |
| Depreciation of tangible fixed assets | | | |
| Owned | | 210,739 | 73,610 |
| Loss on disposal of fixed assets | | - | 10,455 |
| Rentals under operating leases | | | |
| Land and buildings | | 85,614 | 32,685 |
| Auditors' remuneration | | | |
| Audit services | - Group | 17,750 | 15,000 |
| | - Company | 10,000 | 9,500 |
| Non-audit services | - Tax compliance | 3,000 | 5,000 |
| Government grants | | (318,678) | (241,306) |

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 4. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

| | 2006 | 2005 |
|---|---|---|
| | £ | £ |
| **Directors' emoluments** | | |
| Aggregate emoluments | 418,667 | 430,083 |
| Money purchase pension contributions | 15,563 | 18,816 |
| Compensation for loss of office | 5,000 | - |
| | 439,230 | 448,899 |

3 directors are members of money purchase schemes (2005 - 3).

**Remuneration of the highest paid director**

| | 2006 | 2005 |
|---|---|---|
| | £ | £ |
| Aggregate emoluments | 99,200 | 92,201 |
| Money purchase pension contributions | 4,749 | 4,354 |
| | 103,949 | 96,555 |

| | No | No |
|---|---|---|
| **Average number of persons employed** | | |
| Finance and administration | 10 | 7 |
| Research and development | 15 | 8 |
| | 25 | 15 |

| | 2006 | 2005 |
|---|---|---|
| | £ | £ |
| **Staff costs during the year (including directors)** | | |
| Wages and salaries | 987,086 | 844,691 |
| Social security costs | 95,629 | 75,910 |
| Other pension costs | 35,197 | 18,816 |
| | 1,117,912 | 939,417 |

## 4. INFORMATION REGARDING DIRECTORS AND EMPLOYEES (continued)

**Directors' share options**

| | At 1 May 2005 No | Granted No | At 30 April 2006 No | Exercise price | Date from which exercisable | Expiry date |
|---|---|---|---|---|---|---|
| S Massey | 700,000 | - | 700,000 | 25p | (i) | 18/05/2014 |
| F J Heathcote | 7,000,000 | - | 7,000,000 | 5.7p | (ii) | 01/12/2013 |
| | 409,500 | - | 409,500 | 5.7p | 16/05/2003 | 16/05/2010 |
| Lord Peter Walker | 400,000 | - | 400,000 | 50p | 25/06/2005 | 25/06/2014 |
| | 8,509,500 | - | 8,509,500 | | | |

(i) One half of these options became exercisable on the flotation of the company on 11 June 2004 and the remainder became exercisable on 18 May 2005.

(ii) From 1 December 2003, up to one third by 31 March 2004, another third up to 31 March 2005 and the remainder after 31 March 2006.

## 5. TAX ON LOSS ON ORDINARY ACTIVITIES

| | 2006 £ | 2005 £ |
|---|---|---|
| **Current taxation** | | |
| UK corporation tax credit for the year | - | (58,108) |
| Adjustment in respect of prior year | (208) | - |
| Tax credit on loss on ordinary activities | (208) | (58,108) |

In 2005, tax receivable arose from research and development tax credits claimed. For 2006, the group did not qualify to claim these tax credits.

## NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 5. TAX ON LOSS ON ORDINARY ACTIVITIES (continued)

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30% (2005 - 30%). The actual tax credit for the current and the previous year differs from the standard tax rate for the reasons set out in the following reconciliation:

| | 2006<br>£ | 2005<br>£ |
|---|---|---|
| Loss on ordinary activities before tax | (1,857,616) | (1,263,696) |
| Tax at 30% (2005 - 30%) thereon | (557,285) | (379,109) |
| Factors affecting charge for the year: | | |
| Expenses not deductible for tax purposes | 14,019 | 99,532 |
| Capital allowances being in excess of depreciation | (17,603) | (95,171) |
| Research and development tax credit claimed | - | (58,108) |
| Research and development enhanced relief | (32,717) | - |
| Unutilised tax losses carried forward | 593,586 | 374,715 |
| Other deferred tax movements | - | 33 |
| Adjustment in respect of prior year | (208) | - |
| Total actual amount of current tax | (208) | (58,108) |

A net deferred tax asset of £794,590 (2005 - £428,626) has not been recognised in respect of tax losses as there is insufficient evidence that the asset would be recoverable. The net unrecognised deferred tax asset comprises a deferred tax asset of £915,835 in respect of accumulated tax losses and a deferred tax liability of £121,245 in respect of accelerated capital allowances. The unrecognised deferred tax asset would be recoverable to the extent that the company generates sufficient taxable profits in the future.

### 6. PROFIT/ (LOSS) ATTRIBUTABLE TO ITM POWER PLC

The profit for the financial year dealt with in the financial statements of the parent company, ITM Power plc, was £147,255 (2005 - loss £229,051). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

### 7. LOSS PER ORDINARY SHARE

The calculations of earnings per share are based on the following losses and number of shares:

| | Basic and diluted<br>2006<br>£ | <br>2005<br>£ |
|---|---|---|
| Retained loss for the financial period | (1,857,408) | (1,205,588) |
| Weighted average number of ordinary shares for basic loss per share | 91,899,614 | 89,501,418 |

FRS 14 requires presentation of diluted earnings per share when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. For a loss making company with outstanding share options, the net loss per share would be decreased by the exercise of options, and hence no adjustment has been made to the diluted loss per share as presented.

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 8. INVESTMENTS

| Company | Shares in subsidiary undertaking £ |
|---|---|
| **Cost** | |
| At 1 March 2005 and 30 April 2006 | 3,570,000 |

The company holds 100% of the ordinary share capital of ITM Fuel Cells Limited, a company which is registered in England and Wales and its principal activity is the research and development of scientific and engineering projects.

### 9. TANGIBLE FIXED ASSETS

| Group | Laboratory and test equipment £ | Computer equipment £ | Office furniture and fittings £ | Leasehold improve-ments £ | Total £ |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 May 2005 | 338,764 | 60,209 | 10,251 | 106,387 | 515,611 |
| Additions | 410,222 | 26,551 | 15,318 | 189,569 | 641,660 |
| At 30 April 2006 | 748,986 | 86,760 | 25,569 | 295,956 | 1,157,271 |
| **Depreciation** | | | | | |
| At 1 May 2005 | 83,656 | 22,172 | 1,453 | 11,849 | 119,130 |
| Charge for the year | 135,863 | 20,596 | 4,679 | 49,601 | 210,739 |
| At 30 April 2006 | 219,519 | 42,768 | 6,132 | 61,450 | 329,869 |
| **Net book value** | | | | | |
| At 30 April 2006 | 529,467 | 43,992 | 19,437 | 234,506 | 827,402 |
| At 30 April 2005 | 255,108 | 38,037 | 8,798 | 94,538 | 396,481 |

The company has no fixed assets.

## NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 10. DEBTORS

| | Group 2006 £ | Group 2005 £ | Company 2006 £ | Company 2005 £ |
|---|---|---|---|---|
| Due within one year: | | | | |
| Trade debtors | 201 | 800 | - | - |
| Corporation tax | - | 58,108 | - | - |
| Other debtors | 474,073 | 357,295 | 422,748 | 248,326 |
| Amounts due from subsidiary undertaking | - | - | 3,180,696 | 1,845,486 |
| Prepayments | 119,929 | 48,297 | 24,244 | 41,569 |
| | 594,203 | 464,500 | 3,627,688 | 2,135,381 |

### 11. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | Group 2006 £ | Group 2005 £ | Company 2006 £ | Company 2005 £ |
|---|---|---|---|---|
| Bank overdraft | 17,994 | - | - | - |
| Trade creditors | 207,562 | 90,210 | 29,535 | 11,647 |
| Other taxation and social security | 31,796 | 21,124 | 8,861 | 11,491 |
| Accruals and deferred income | 36,088 | 50,465 | 1,500 | 1,968 |
| | 293,440 | 161,799 | 39,896 | 25,106 |

### 12. CALLED UP SHARE CAPITAL

| | 2006 £ | 2005 £ |
|---|---|---|
| Authorised: | | |
| 125,000,000 ordinary shares of 5p each | 6,250,000 | 6,250,000 |
| Called up, allotted and fully paid: | | |
| 91,970,250 (2005 - 91,874,250) ordinary shares of 5p each | 4,598,513 | 4,593,713 |

On 7 September 2005, as a result of share option exercises, a further 19,000 ordinary shares were issued for total proceeds of £1,086 resulting in a premium of £136.

On 28 February 2006, as a result of share option exercises, a further 77,000 ordinary shares were issued for total proceeds of £4,400 resulting in a premium of £550.

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 12. CALLED UP SHARE CAPITAL (continued)

The total number of share options over ordinary shares of 5p each at 30 April 2006 is as follows:

| Number of options No | Exercise price per share | Date from which exercisable | Expiry date |
|---|---|---|---|
| 400,000 | 50p | 25/06/2005 | 25/06/2014 |
| 700,000 | 25p | (i) | 18/05/2014 |
| 7,000,000 | 5.7p | (ii) | 01/12/2013 |
| 409,500 | 5.7p | 16/05/2003 | 16/05/2010 |
| 1,050,000 | 5.7p | *17/06/2005 | 01/12/2010 |
| 70,000 | 5.7p | **01/12/2005 | 01/12/2010 |
| 70,000 | 5.7p | 17/06/2003 | 17/06/2010 |
| 70,000 | 5.7p | 19/04/2004 | 19/04/2011 |
| 140,000 | 5.7p | 16/05/2003 | 16/05/2010 |
| 9,909,500 | | | |

(i) One half of these options became exercisable on the flotation of the company on 11 June 2004 and the remainder became exercisable on 18 May 2005.

(ii) From 1 December 2003, up to one third by 31 March 2004, another third up to 31 March 2005 and the remainder after 31 March 2006.

* These share options were issued in two equal tranches, the first on 17 June 2003 and the second on 8 October 2003. A quarter of the first tranche of option shares granted became exercisable on 17 June 2005 with further quarters of this tranche becoming exercisable each year on 17 June until 17 June 2008 when all of this first tranche becomes exercisable. The second tranche becomes exercisable in similar proportions as the first, on each year on 8 October from 8 October 2005 to 8 October 2008.

** One quarter of these shares becomes exercisable after 1 December 2005, a further quarter becomes exercisable after 1 December 2006, a further quarter becomes exercisable after 1 December 2007 and the remaining quarter becomes exercisable after 1 December 2008.

Of the total share options outstanding at the year end, 2,870,000 share options have been granted under an Enterprise Management Incentive share option scheme and the remaining 7,039,500 share options have been granted under an unapproved share option scheme.

## NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 13. RESERVES

| GROUP | Share premium account £ | Merger reserve £ | Profit and loss account £ | Total £ |
|---|---|---|---|---|
| At 1 May 2005 | 8,102,850 | (1,972,820) | (2,281,092) | 3,848,938 |
| Retained loss for the year | - | - | (1,857,408) | (1,857,408) |
| Shares issued in the year (net of expenses) | 686 | - | - | 686 |
| At 30 April 2006 | 8,103,536 | (1,972,820) | (4,138,500) | 1,992,216 |

| COMPANY | Share premium account £ | Profit and loss account £ | Total £ |
|---|---|---|---|
| At 1 May 2005 | 8,102,850 | (229,051) | 7,873,799 |
| Retained profit for the period | - | 147,255 | 147,255 |
| Shares issued in the period (net of expenses) | 686 | - | 686 |
| At 30 April 2005 | 8,103,536 | (81,796) | 8,021,740 |

### 14. RECONCILIATION OF MOVEMENTS IN GROUP SHAREHOLDERS' FUNDS

| | 2006 £ | 2005 £ |
|---|---|---|
| Loss for the year | (1,857,408) | (1,205,588) |
| Share related charges | - | 175,000 |
| New shares issued (net of expenses) | 5,486 | 9,126,563 |
| Net (reduction in) addition to shareholders' funds | (1,851,922) | 8,095,975 |
| Opening shareholders' funds | 8,442,651 | 346,676 |
| Closing shareholders' funds | 6,590,729 | 8,442,651 |

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 15. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

The group's financial instruments comprise cash and short term deposits, debtors and creditors, which arise in the normal course of business. It is, and has been throughout the period under review, the group's policy that no speculative trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are interest rate risk and liquidity risk.

This note deals with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS 13").

As permitted by FRS 13, short term debtors and creditors have also been excluded from the disclosures, other than the currency disclosures.

**Interest rate risk and liquidity risk**

The group has no financial assets other than sterling cash deposits of £5,400,000 (2005 - £7,550,000) and cash at bank and in hand of £62,564 (2005 - £193,469) which are part of the financing arrangements of the group. The sterling cash deposits comprise amounts placed on deposit at fixed interest rates for periods of up to one year and at call. The group seeks to maximise interest receipts within these parameters. Interest receipts are earned on deposits at the prevailing rate.

The group's policy throughout the periods presented has been to minimise the risk by placing funds in low risk cash deposits but to also maximise the return on funds placed on deposit.

**Interest rate profile**

The weighted average interest rate in respect of sterling deposits for the year ended 30 April 2006 was 4.4% (2005 - 4.8%). The weighted average period to maturity for which these rates were fixed was 19 days (2005 - 30 days).

**Currency risk**

The group's principal functional currency is pounds sterling. The company has limited exposure to foreign currencies.

The group held the following financial assets at 30 April 2006.

| | 2006 | 2005 |
|---|---|---|
| | £ | £ |
| Assets held as part of the financing arrangements of the group | | |
| Sterling cash deposits | 5,400,000 | 7,550,000 |
| Cash at bank and in hand | 62,564 | 193,469 |
| | 5,462,564 | 7,743,469 |

**Fair values of financial assets**

The directors consider there to be no material difference between the book value of financial assets and their fair value at the balance sheet dates.

**Borrowing facilities**

The group had no borrowing facilities throughout the period.

**Market price risk**

The principal market price risk comprises interest rate exposure. The group's funds are invested in cash deposits with the objective of maintaining a balance between accessibility of funds and competitive rates of return.

**Liquidity risk**

The group's policy throughout the period regarding liquidity has been to maximise the return on funds placed on deposit but to minimise the associated risk by placing funds in low risk cash deposits.

## NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 16. RECONCILIATION OF OPERATING LOSS TO OPERATING CASH FLOWS

| | 2006<br>£ | 2005<br>£ |
|---|---|---|
| Operating loss | (2,147,828) | (1,610,157) |
| Depreciation charge | 210,739 | 73,610 |
| Loss on disposal of fixed assets | - | 10,455 |
| Increase in debtors | (87,431) | (35,004) |
| Increase in creditors | 113,647 | 30,273 |
| UITF 17 charge | - | 175,000 |
| Net cash outflow from operating activities | (1,910,873) | (1,355,823) |

### 17. ANALYSIS OF CASH FLOWS

| | 2006<br>£ | 2005<br>£ |
|---|---|---|
| *Returns on investments and servicing of finance* | | |
| Bank interest received | 189,832 | 121,503 |
| **Net cash inflow** | 189,832 | 121,503 |
| *Taxation* | | |
| Research and development tax credit received | 58,316 | 43,555 |
| **Net cash inflow** | 58,316 | 43,555 |
| *Capital expenditure and financial investment* | | |
| Purchase of tangible fixed assets | (641,660) | (383,212) |
| **Net cash outflow** | (641,660) | (383,212) |
| *Management of liquid resources* | | |
| Cash withdrawn from (placed on) term deposits | 2,150,000 | (7,274,524) |
| *Financing* | | |
| Issue of ordinary share capital (net of expenses) | 5,486 | 9,126,563 |
| **Net cash inflow** | 5,486 | 9,126,563 |

# NOTES TO THE FINANCIAL STATEMENTS
# Year ended 30 April 2006

## 18. ANALYSIS AND RECONCILIATION OF NET FUNDS

| | 1 May 2005 £ | Cash flow £ | 30 April 2006 £ |
|---|---|---|---|
| Cash at bank and in hand | 193,469 | (130,905) | 62,564 |
| Bank overdraft | - | (17,994) | (17,994) |
| | | (148,899) | |
| Current asset investments | 7,550,000 | (2,150,000) | 5,400,000 |
| Net funds | 7,743,469 | (2,298,899) | 5,444,570 |

| | 2006 £ | 2005 £ |
|---|---|---|
| (Decrease) increase in cash in the year | (148,899) | 278,062 |
| Cash (inflow) outflow from (decrease) increase in liquid resources | (2,150,000) | 7,274,524 |
| Change in net funds resulting from cash flows | (2,298,899) | 7,552,586 |
| Net funds at beginning of year | 7,743,469 | 190,883 |
| Net funds at end of year | 5,444,570 | 7,743,469 |

## 19. GUARANTEES AND OTHER FINANCIAL COMMITMENTS

### a) Capital commitments

Capital commitments are as follows:

| Group | 2006 £ | 2005 £ |
|---|---|---|
| Contracted for but not provided for | 18,050 | 29,788 |

**Company**

The company had no capital commitments at 30 April 2006.

### b) Operating lease commitments

Annual commitments under non-cancellable operating leases are as follows:

| Group | Land and buildings 2006 £ | Land and buildings 2005 £ |
|---|---|---|
| Expiry date | | |
| - within one year | - | 19,230 |
| - between two and five years | 51,000 | 8,348 |
| | 51,000 | 27,578 |

**Company**

The company has no operating leases.

# NOTES TO THE FINANCIAL STATEMENTS
## Year ended 30 April 2006

### 20. TRANSACTIONS WITH RELATED PARTIES

Included within creditors is a balance of £81 (2005 - £nil) with Dental Root Filling Products Limited, a company incorporated in the United Kingdom, and a company in which J A D Wreford and J A Lloyd are both directors. Costs incurred during the year by Dental Root Filling Products Limited on behalf of the group, for an amount of £1,050 (2005 - £30,963), have been recharged to the group at cost.

### 21. CONTROLLING PARTY

As at the date of these accounts, the directors, together, owned less than 50% of the issued share capital of the company and hence, in the opinion of the directors, there is no controlling party at this date.

### 22. POST BALANCE SHEET EVENT

Subsequent to year end, ITM Power plc raised £29.4 million through a placing of 9.2 million ordinary shares with institutional investors.