Surface Transforms plc

Annual Report and Financial Statements

Registered number 3769702

31 May 2009

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Highlights

- Revenue increased by 34% to £679,284 *(2008: £508,111)*
- Losses after taxation £840,740 *(2008: £594,065)*
- Cash position as at 31 May 2009 of £404,275 *(2008: £1,112,719)*
- Order Book of £166,370 as at 31 May 2009, which had grown to £308,108 by 5 August 2009.
- Sales to the Defence and Aerospace Markets increased by 182% to £236,279.
- ISO 9001 Qualification was achieved – a pre-requisite for doing business in the aerospace and automotive sectors.
- Completion of the CVIST process for carbon infiltration so reducing the unit cost of an automotive disc by 20 per cent.
- In December 2008, the award of a further £100,000 order from MBDA, Europes leading missile supplier.
- The award of a multi-year contract with Mov'it GmbH, a leading supplier of high performance brake systems within the European aftermarket, which is forecast to yield revenues of £300,000 to £400,000 per annum in future years.

Chairman's statement

In the 12 months to 31 May 2009 the Company achieved a number of strategic and operating milestones although this was against the background of a severe global recession and a sustained reduction of output within the automotive industry. The key milestones were:

- The award of a multi-year contract with Mov'it GmbH, a leading supplier of high performance brake systems within the European aftermarket, which is forecast to yield revenues of £300,000 to £400,000 per annum in future years.
- ISO 9001 qualification.
- Completion of the CVIST manufacturing project which provides the capability of the carbon infiltration of discs in house and contributes to the reduction in manufacturing costs of approximately 20% for an automotive brake disc.
- A further £100,000 contract from MBDA the European leader in missile and rocket technology.

There were disappointments as well and these resulted from the very sharp decline in business confidence during the final months of 2008 and the first quarter of 2009. In February 2009, we signalled that the Company's revenues for the full year would fall short of the market expectations that were set in August 2008 and that the principal cause of the revenue reduction was a prospective fall in orders from our automotive customers. The Company has now met its revised expectations for revenues and operating losses for the full year. Business in the year was considerably higher than budget from the aerospace and defence market sectors and this provides the Company with a platform for growth despite the continued low levels of business expected from the automotive sector during the remainder of 2009 and most of 2010.

Financial review

In the 12 months to 31 May 2009, revenue was £679,284 (2008: £508,111). This represents an increase of 34% over the prior year.

At 31 May the Order Book, representing confirmed orders, was £166,370 (2008: £302,124). The reduction in the order book level over the period is mainly due to the reduction in business from the automotive sector, however, the order book has grown to £308,108 by 5 August 2009. The Order Book does not reflect orders not yet placed with regards to the annual, multi-year supply contracts the Company has signed during 2008 with MBDA for rocket components; for carbon-ceramic brake automotive discs with Mov'it or for the supply of carbon brake discs with a leading European brake systems group.

Losses after taxation for the 12 month period were £840,740 (2008: £594,065). These include a non cash charge of £94,424 (2008: £56,609) relating to share based payments under IFRS 20.

Earnings per share for the year was a loss of 4.42p (2008: 3.33p)

Capital Expenditure in the period was £71,428 (2008: £142,599)

The Company had a Cash balance of £404,275 (2008: £1,112,719) at 31 May 2009 and it has no borrowings.

Shareholder Funds at 31 May 2009 were £1,026,523 (2008: £1,722,839)

Developments

The Company has progressed sufficiently far in the application of its technology that it now has a number of global based customers operating in each of its main end user markets: Aerospace & Defence; High Performance Automotive and the Automotive Race Market.

A number of these clients are either evaluating the Company's technology for license or are purchasing brake discs or rocket components for their development programmes or for commercial use.

Chairman's statement (Continued)

Developments (Continued)

To facilitate the management of the operations and to ensure its core Intellectual Property (IP) is fully protected, the Company has created four wholly owned operating subsidiaries. The IP and the management is held within the Group plc company and the technology is licensed down to each subsidiary. This means that Licensing and Commercial supply agreements within each subsidiary are kept separate and the Group can now consider the sale of one or more of its subsidiaries should the opportunity arise. The new Group structure commenced 1 June 2009.

People

Mr. Julio Faria, one of the founder directors, left the board during December 2008 and now has sold the majority of his shareholding in the Company. We wish him well for the future.

Outlook

The Group is focussed on achieving new business wins in the aerospace and defence markets whilst it recognises that business from the automotive brake sector will remain subdued until well into the second half of 2010. The Chief Executive's report describes the opportunities in each of the main user markets and there is good reason to be confident that we shall report improved results in the 2010 financial year.

Management has reduced the overhead base by an estimated £200,000 p.a going forward and the Company has received initial notice from the DTI that it has been awarded another multi year development grant which will reduce overheads further and improve cash flows.

The Company secured a fundraising of £410,000 net of expenses during July 2009. The issue of 4,516,580 new ordinary shares at 10 pence per share will take place on 13 August 2009. This will be used to assist with working capital needs over the next 24 months.

Whilst forecasting accurately can be difficult in these economic conditions, the board is cautiously optimistic that it can increase business revenues and reduce losses in the 2010 financial year ending 31 May 2010 and work towards breaking even in cash terms.

Kevin D'Silva
Chairman

12 August 2009

Chief executive's report

Automotive - High performance and Race car brake systems

Following the sharp economic decline within the automotive market, income from the automotive sector has remained steady year on year with growth in overall turnover being achieved in other areas, as described below. As a result, sales to automotive customers represented 65% of total turnover compared to 84% in 2008.

The Company has three main automotive contracts:

- Supply of ceramic discs to Mov'it GMBH - a leading European aftermarket brake system supplier.
- Supply of carbon fibre brake discs to a global automotive brake system supplier.
- Supply of ceramic discs to Koenigsegg Automotive - supplier of high performance super cars.

Sales to Koenigsegg have remained strong; however revenue from the other two contracts, both with forecasted annual revenues of £300,000-£400,000, has been significantly below the company's initial expectations in July 2008.

The Company recognises that trading conditions for the Company's current automotive contracts will remain difficult well into 2010.

In addition to the Company's existing contracts the Company continues to work to bring in new business, receiving new orders from a US brake system supplier which has won the contract to supply approximately 20 prototype vehicles for the next generation of US military transport vehicle.

Aerospace

The company continues to work on development programmes with two aircraft brake system suppliers.

Meggitt Aircraft Braking Systems (MABS) has been and remains a key partner of the £1.34 million, three year collaborative R&D project funded by the UK Technology Strategy Board (formerly the DTI). This project is being led by Surface Transforms.

The second development programme is with a US brake system supplier that supplies both commercial and military aircraft principally in US markets. The Company and the customer are pleased with both the pace of development and the technical advances made during the last 12 months, with the Company progressing through a number of key technical milestones.

It is always very difficult to predict the adoption of new technologies and the aerospace market is no different. The Company expects the development programme with the US supplier to continue to progress, with the focus on the development and commercialisation of the company's proprietary carbon ceramic technology.

Defence: Rocket Components

Surface Transforms carbon ceramic technology is uniquely positioned to deliver affordable, high performance (in terms of extended life and reduced mass) rocket components.

During the last 12 months the company has seen the level of interest increase significantly, with the defence sector providing >25% of the group's revenues during the financial year.

We have successfully completed year one of a three year development programme with MBDA, a world leading missile manufacturer jointly owned by BAe Systems, EADS and Finmeccanica. The £150,000 contract of over three years generated some positive results and lead to additional revenues from MBDA including an additional contract in excess of £100,000 to further investigate and accelerate the development. We are also pleased that the company has been officially awarded the year two contract with MBDA and continues to work closely with MBDA

Chief executive's report (Continued)

Defence: Rocket Components (Continued)

who recognise the potential for the carbon ceramic technology and are focused on the development of the material for use in its range of products.

The company has signed a new contract for £75,000 over 3 years with the UK MoD (Ministry of Defence). The programme although small is strategically important to the MoD with Surface Transforms technology offering the potential of affordable, high performing ceramic composite components for the future.

In addition the award of a £200,000, 2 year development contract with Microturbo, a world leading turbojet engine manufacturer, for the development of carbon ceramic components for turbojet engines further recognises the potential for use of the materials in demanding environments which require affordable solutions.

The company expects the defence sector to continue to make a significant contribution to the group revenues going forward.

Operations

Affordability is a key requirement for all of our chosen markets, particularly with the current economic pressures the world is facing. The development and commissioning of CVIST, the carbon vapour infiltration process plant has been completed and has reduced the cost to manufacture a ceramic brake disc by 20%.

The operations team successfully achieved ISO 9001 accreditation in September 2008. An important milestone for the business in terms of continuous improvements and a prerequisite to truly operating in our chosen market.

In the autumn of 2008 the management recognised the change in trading conditions in the automotive sector and took steps to reduce its operational cost base by £200,000. The savings came from two areas. Some non-recurring costs associated with achieving ISO accreditation and bringing the CVIST plant online as well as a reduction in production resources to reflect the reduced demand in two of our main automotive contracts.

People

The company has a strong senior management team who have shown tremendous commitment and maturity during the last 12 months.

The blend of skills, experience and determination within the team means we are well placed to continue the good progress made to date.

I would like to thank all my colleagues for their dedication over the past year.

Dr. Kevin Johnson
Chief Executive

12 August 2009

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 May 2009.

Principal activity

The principal activity of the Company during the year was the development and manufacture of carbon fibre reinforced ceramic products (CFRC) for aircraft brake, automotive brake and rocket component applications.

Business review

A review of the Company's activities during the year is dealt with in the financial review section of the Chairman's statement (page 2).

Key risks and uncertainties

As in previous years the principal risk faced by the Company is considered to be the speed at which our customers and potential customers adopt the new ceramic disc technology. Indications in the automotive area are that the technology continues to be well received and is being adopted over an increasing number of vehicles. This risk is constantly assessed by monitoring the level of enquiries and orders for both the Company and industry wide. In addition the Company faces the continuing uncertainty created by the current economic climate, particularly within the automotive sector.

Key performance indicators

The Directors continue to monitor the business internally with a number of performance indicators: order intake, sales output, profitability and manufacturing cost of automotive discs. The company has met its revised performance targets in each of these areas – please see Chairman's report for more details:

- Turnover £679,284 *(2008: £508,111)*
- Losses after taxation £840,740 *(2008: £594,065)*
- Order Book of £166,370 (as at 31 May 2009)
- Completion of the CVIST process for carbon infiltration so reducing the unit cost of an automotive disc by 20 per cent.

The Company produces an annual business plan and full monthly forecasts detailing sales, profitability and cash flow to help monitor business performance going forward.

Future developments

The Board aims to continue with its corporate strategy which is to exploit its technologies in carbon fibre reinforced ceramics by:

- establishing contract development opportunities and collaborations with national and multi-national customers in the aerospace and automotive industries; and
- expanding commercial sales of CFRC products.

Research and development

The majority of the Company's staff are employed in research activities which are concentrated on the ongoing identification of new products and applications for carbon fibre reinforced ceramic friction and non-friction materials.

Proposed dividend and transfer to reserves

The loss for the year after taxation amounted to £840,740 *(2008: £594,065)*. The directors do not recommend the payment of a dividend.

Directors' report *(continued)*

Policy and practice on payment of payables

It is the Company's policy that payments to suppliers are made in accordance with the terms and conditions agreed between the Company and its suppliers, providing that all trading terms and conditions have been complied with. The Company does not follow any code or standard on payment practice.

At the year end, there were 27 days *(2008: 53 days)* purchases in trade payables.

Political and charitable donations

The Company made no political or charitable donations during the year *(2008: £nil)*.

Directors and directors' interests

The directors who held office during the year were as follows:

K D'Silva* (Chairman)
Dr K Johnson (Managing Director)
JJ Faria*
Professor DT Clark*
Dr G Gould
KM Baker*

* denotes non-executive Director.

JJ Faria resigned as a non-executive director on 03 December 2008.

The directors retiring by rotation are K Johnson and DT Clark who, being eligible, offer themselves for re-election.

The directors who held office at the end of the financial year had the following interests in the ordinary shares of the Company according to the register of directors' interests:

		Number of £0.01 ordinary shares	
	% of issued share capital at end of year	**Interest at end of year**	Interest at start of year
Professor DT Clark	**5.15**	**979,661**	979,661
K D'Silva	**1.35**	**256,986**	256,986
Dr K Johnson	**0.42**	**79,750**	79,750
KM Baker	**0.47**	**90,000**	90,000
Dr G Gould	**0.02**	**4,350**	4,350

According to the register of directors' interests, no rights to subscribe for shares in or debentures of the Company were granted to any of the directors or their immediate families, or exercised by them during the financial year, except as disclosed in the report on directors' remuneration on pages 9 and 10.

The directors benefited from qualifying third party indemnity provisions in place during the financial year and at the date of this report.

Directors' report *(continued)*

Substantial shareholders

In addition to the directors' interests noted above, the directors are aware of the following who were interested in 3% or more of the Company's equity as of 13 July 2009:

Registered holding	Number of ordinary shares	% of issued share capital
TD Waterhouse Nominess (Europe)	**5,238,599**	27.53%
JM Finn Nominees Limited	**3,869,860**	20.33%
Octopus Investments Nominees	**986,420**	5.18%
Pershing Nominees Limited	**785,000**	4.12%

Corporate governance

Surface Transforms plc is committed to maintaining high standards of corporate governance. The Company complies with the Combined Code as modified by the recommendations of the Quoted Companies Alliance to the extent the directors consider appropriate, given the size of the Company, its current stage of development and the constitution of the Board.

The Board has appointed an Audit Committee whose primary role is to review the Company's interim and annual financial statements before submission to the Board for approval. The Board has also appointed a Remuneration Committee, which is responsible for reviewing executive remuneration and performance. The Remuneration and Audit Committees are made up of three non-executive directors, David Clark, Kevin D'Silva and Ken Baker. Details of the Remuneration Committee are disclosed in the report on directors' remuneration on pages 9 and 10.

Disclosure of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG Audit Plc as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

Fund raising

The Company secured a fundraising of £410,000 net of expenses during July 2009 by the issue of new ordinary shares at 10 pence per share. This will be completed on 13 August 2009 and used to assist with working capital needs over the period of the next 24 months.

Post balance sheet events

To facilitate the management of the operations and to ensure its core Intellectual Property (IP) is fully protected, the Company has created 4 wholly owned operating subsidiaries. The IP and the management is held within the Group plc company and the technology is licensed down to each subsidiary.

By order of the Board

K D'Silva- Chairman

12 August 2009

Unit 4 Olympic Park
Poole Hall Road, Ellesmere Port
Cheshire, CH66 1ST

Report on directors' remuneration

Policy on executive directors' remuneration

The Remuneration Committee comprises of Kevin D'Silva, David Clark and Ken Baker.

The Remuneration Committee is responsible for reviewing and determining the Company's policy on executive remuneration (including the grant of options under the Share Option Scheme) and ensuring compliance with and implementation by the Company, as far as reasonably practicable, of the recommendations and guidelines of the Combined Code. Executive remuneration packages are designed to ensure the Company's executive directors and senior executives are fairly rewarded for their individual contributions to the Company.

Fees for non-executive directors

The fees for non-executive directors are determined by the Board. The non-executive directors are not involved in the decisions about their own remuneration.

Directors' remuneration

Set out below is a summary of the fees and emoluments received by all directors for the year or, where applicable, period of office:

	2009	2008
	£	£
Executive directors		
Dr K Johnson	115,912	84,399
JJ Faria*	-	30,049
Dr G Gould	44,282	53,943
	160,194	168,391
Non-executive directors		
K D'Silva	27,000	18,000
Professor DT Clark	18,000	18,253
JJ Faria*	10,004	9,000
KM Baker	18,000	18,000
	73,004	63,253
	233,198	231,644

With the exception of Kevin Johnson, none of the directors received pension contributions in respect of their office. In addition to the emoluments received, as stated above, Kevin Johnson received £4,667 (*2008: £3,898*) in respect of pension contributions.

*JJ Faria resigned as a non-executive director on 3 December 2008.

Directors' interests

Details of any contracts in which a director has a material interest are disclosed in note 17.

None of the directors received any remuneration or benefits under long term incentive schemes.

Report on directors' remuneration *(continued)*

Share options

The Company operates a share incentive scheme. All options are granted at the discretion of the Board. The options granted, date of grant, exercise price and exercise periods under the scheme are set out below.

None of the directors exercised options during the year. Dr K Johnson and Dr G Gould surrendered options during the year. Directors' options outstanding and the options which were granted, surrendered and expired during the year are as follows:

Enterprise Management Incentive Scheme

Director	Date of Grant	Holding on 1st June 2008	Granted during the year	Number of Share options expired, waived or lapsed	Holding on 31st May 2009	Exercise Price	Exercise Period	Expiry Date
JJ Faria	19/12/2002	64,286	-	64,286	-	£0.7000	19/12/05-19/12/12	19/12/2012
Dr G Gould	19/12/2002	64,286	-	64,286	-	£0.7000	19/12/05-19/12/12	19/12/2012
Dr G Gould	08/12/2003	34,091	-	34,091	-	£0.8800	08/12/06-08/12/13	08/12/2013
Dr G Gould	08/03/2004	20,000	-	20,000	-	£0.6650	08/03/07-08/03/14	08/03/2014
Dr G Gould	14/09/2005	29,000	-	29,000	-	£0.4000	14/09/08-14/09/15	14/09/2015
Dr G Gould	18/04/2007	50,000	-	-	50,000	£0.2100	18/04/10-18/04/17	18/04/2017
Dr G Gould	30/06/2008	-	86,000	-	86,000	£0.1825	30/06/11-30/06/18	30/06/2018
Dr G Gould	22/09/2008	-	21,219	-	21,219	£0.1850	22/09/11-22/09/18	22/09/2018
Dr K Johnson	04/04/2005	50,000	-	50,000	-	£0.5000	04/04/08-04/04/15	04/04/2015
Dr K Johnson	14/09/2005	180,000	-	180,000	-	£0.4000	14/09/08-14/09/15	14/09/2015
Dr K Johnson	18/04/2007	100,000	-	-	100,000	£0.2100	18/04/10-18/04/17	18/04/2017
Dr K Johnson	30/06/2008	-	288,000	-	288,000	£0.1825	30/06/11-30/06/18	30/06/2018
Dr K Johnson	22/09/2008	-	481,707	-	481,707	£0.1850	22/09/11-22/09/18	22/09/2018
Prof. DT Clark	18/04/2007	15,000	-	-	15,000	£0.2100	18/04/10-18/04/17	18/04/2017
KA D'Silva	18/04/2007	50,000	-	-	50,000	£0.2100	18/04/10-18/04/17	18/04/2017
KM Baker	18/04/2007	15,000	-	-	15,000	£0.2100	18/04/10-18/04/17	18/04/2017
		671,663	876,926	441,663	1,106,926			

The market price of the shares at 31 May 2009 was £0.115 and during the year varied from £0.195 to £0.075.

By order of the board

K D'Silva
Chairman

12 August 2009

Unit 4
Olympic Park
Poole Hall Road
Ellesmere Port
Cheshire
CH66 1ST

Statement of directors' responsibilities in respect of the annual report and the financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU 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 company and of the profit or loss of the company 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 estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

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

KPMG Audit Plc
St James' Square
Manchester M2 6DS
United Kingdom

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SURFACE TRANSFORMS PLC

We have audited the financial statements of Surface Transforms Plc for the year ended 31 May 2009 set out on pages 14 to 36. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the company's members, as a body, in accordance with sections 495 and 496 of the Companies Act 2006. 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

As explained more fully in the Directors' Responsibilities Statement set out on page 11, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the 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 (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 May 2009 and of its Loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; 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 financial statements are prepared is consistent with the financial statements.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SURFACE TRANSFORMS PLC *(continued)*

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements 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.

Richard Evans (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
St James' Square
Manchester M2 6DS
United Kingdom

14 August 2009

Income Statement
for the year ended 31 May 2009

	Note	2009	2008
		£	£
Revenue	*2*	**679,284**	508,111
Cost of sales		**(282,487)**	(252,874)
Gross profit		**396,797**	255,237
Administrative expenses:			
Before research costs		**(733,700)**	(615,617)
Research costs		**(839,509)**	(678,078)
Total administrative expenses		**(1,573,209)**	(1,293,695)
Other operating income	*3*	**166,035**	220,652
Operating loss		**(1,010,377)**	(817,806)
Financial income	*6*	**20,646**	67,347
Financial expenses	*6*	**(1,854)**	-
Loss before tax		**(991,585)**	(750,459)
Taxation	*7*	**150,845**	156,394
Loss for the year	*15*	**(840,740)**	(594,065)
Loss per ordinary share			
Basic and diluted	*18*	**(4.42p)**	(3.33p)

All amounts relate to continuing activities.

Statement of Changes in Equity
as at 31 May 2009

2008	Share Capital	Share premium account	Capital reserve	Profit and loss account	Total
	£	£	£	£	£
Loss for the year	-	-	-	(594,065)	(594,065)
Total recognised income and expense	-	-	-	(594,065)	(594,065)
Credit in relation to share based payments	-	-	-	56,609	56,609
Issue of new shares	50,000	847,237	-	-	897,237
Opening shareholders funds at 1 June 2007	140,308	4,902,715	463,885	(4,093,850)	1,413,058
Closing shareholders funds at 31 May 2008	190,308	5,749,952	463,885	(4,631,306)	1,772,839

2009	Share Capital	Share premium account	Capital reserve	Profit and loss account	Total
	£	£	£	£	£
Loss for the year	-	-	-	(840,740)	(840,740)
Total recognised income and expense	-	-	-	(840,740)	(840,740)
Credit in relation to share based payments	-	-	-	94,424	94,424
Opening shareholders funds at 1 June 2007	190,308	5,749,952	463,885	(4,631,306)	1,772,839
Closing shareholders funds at 31 May 2008	190,308	5,749,952	463,885	(5,377,622)	1,026,523

Balance sheet
at 31 May 2009

	Note	2009		2008	
		£	£	£	£
Non-current assets					
Property, plant and equipment	8		**382,448**		382,975
			382,448		382,975
Current assets					
Inventories	9	**228,251**		258,874	
Trade and other receivables	10	**212,851**		292,923	
Cash and cash equivalents		**404,275**		1,112,719	
Total Current Assets			**845,377**		1,664,516
Total Assets			**1,227,825**		2,047,491
Current Liabilities					
Other interest bearing loans and borrowings	11	**(14,438)**		-	
Trade and other payables	12	**(168,669)**		(274,652)	
Total Current Liabilities		**(183,107)**		(274,652)	
Non Current Liabilities					
Other interest bearing loans and borrowings	11	**(18,195)**		-	
Total Liabilities			**(201,302)**		(274,652)
Net assets			**1,026,523**		1,772,839
Equity					
Share capital	14		**190,308**		190,308
Share premium	15		**5,749,952**		5,749,952
Capital reserve	15		**463,885**		463,885
Retained earnings	15		**(5,377,622)**		(4,631,306)
Total equity attributable to equity shareholders of the Company			**1,026,523**		1,772,839

These financial statements were approved by the board of directors on 12 August 2009 and were signed on its behalf by:

K D'Silva
Director

Dr K Johnson
Director

Cash flow statement
for the year ended 31 May 2009

	Note	**2009**	2008
		£	£
Cash flows from operating activities			
Loss for the year		**(840,740)**	(594,065)
Adjusted for:			
Depreciation charge		**71,282**	49,079
Amortisation charge		**-**	1,886
Profit on disposal of plant and equipment		**(4,402)**	-
Equity settled share-based payment expenses		**94,424**	56,609
Financial income		**(20,646)**	(67,347)
Financial expense		**1,854**	-
Taxation		**(150,845)**	(156,394)
		(849,073)	(710,232)
Changes in working capital			
Decrease/(Increase) in inventories		**30,623**	(46,693)
Decrease/(Increase) in trade and other receivables		**80,072**	(3,347)
Decrease/(Increase) in trade and other payables		**(105,983)**	15,641
		(844,361)	(744,631)
Finance income received		**20,646**	67,347
Financial expense paid		**(1,854)**	-
Taxation received		**150,845**	156,394
Net cash used in operating activities		**(674,724)**	(520,890)
Cash flows from investing activities			
Acquisition of property, plant and equipment		**(22,150)**	(142,599)
Proceeds from sale of property, plant and equipment		**5,075**	-
Net cash used in investing activities		**(17,075)**	(142,599)
Cash flows from financing activities			
Proceeds from issue of share capital		**-**	897,237
Payment of finance lease liabilities		**(16,645)**	-
Net cash from financing activities		**(16,645)**	897,237
Net decrease/(increase) in cash and cash equivalents		**(708,444)**	233,748
Cash and cash equivalents at the beginning of the period		**1,112,719**	878,971
Cash and cash equivalents at the end of the period		**404,275**	1,112,719

Notes
(forming part of the financial statements)

1 Accounting policies

Surface Transforms plc (the "Company") is a company incorporated and domiciled in the UK.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU.

The financial statements were approved by the board on 12 August 2009.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention, as modified for financial assets and liabilities at fair value through the income statement.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Going concern

The financial statements have been prepared on a going concern basis which the directors believe to be appropriate. The Company incurred a net loss of £840,740 during the year however the directors are satisfied, based on detailed cash flow projections, that sufficient cash is available to meet the Company's needs as they fall due for at least 12 months from the date of signing the accounts. Revenues are expected to continue to increase in the coming years resulting in the company becoming profitable in due course. In addition the Company has secured a fundraising of £410,000 net of expenses during July 2009. The issue of new ordinary shares at 10 pence per share will take place on 13 August 2009..

The Company's business activities, together with the factors likely to affect future development, performance and position are set out in the Chairman's statement on pages 4 to 5 and the Director's report on pages 8 to 10. In addition, note 19 to the financial statements includes the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and its exposures to credit risk and liquidity risk.

The directors believe that the group is well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the directors have a reasonable expectation that the Company and has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Share based payments

The share option programme allows employees to acquire shares of the Company. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using an option pricing model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

Intangible assets and amortisation

Expenditure on patents is capitalised and amortised to nil by equal annual instalments over the useful economic life of seven and a half years.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Notes *(continued)*

1 Accounting policies *(continued)*

Property, plant and equipment (continued)

Leases in which the Company assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and less accumulated impairment losses. Lease payments are accounted for as described below.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

- Plant and machinery - 12.5%-20% per annum
- Fixtures and fittings - 15% per annum
- Motor vehicles - 25% per annum
- Leasehold improvements - Over life of lease

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the foreign exchange rate ruling at the balance sheet date and the gains or losses on translation are included in the income statement.

Leases

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Government grants

Revenue grants are credited to the profit and loss account, and included within other operating income, so as to match them with expenditure to which they relate.

Post retirement benefits

The Company does not operate a pension scheme, but does contribute to specific employees' personal pension schemes. The amount charged to the profit and loss account represents the contributions payable to employees personal pension schemes during the accounting year.

Research and development expenditure

Expenditure on research activities is recognised in the income statement as an expense as incurred.

Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Company intends and has the technical ability and sufficient resources to complete development, future economic benefits are probable and if the Company can measure reliably the expenditure attributable to the intangible asset during its development. No research costs met the criteria for capitalisation in the current or preceding years.

Notes *(continued)*

1 Accounting policies *(continued)*

Inventories

Inventories are stated at the lower of cost and net realisable value. In determining the cost of raw materials and consumables the purchase price is used. For work in progress, cost is taken as production cost, which includes an appropriate proportion of attributable overheads.

Taxation

The charge for taxation is based on the loss for the year and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes.

Deferred taxation is provided for in full at the tax rate which is expected to apply to the period when the deferred taxation is expected to be realised, including on tax losses carried forward.

Deferred taxation assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Research and development tax credits are recognised on a cash received basis as a reduction in the current tax payable as this is when the tax credit is considered recoverable.

Cash and cash equivalents

Cash and cash equivalents, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand.

New standards and interpretations that have been endorsed, but which are not yet effective and not early adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 May 2009 and have not been applied in preparing these financial statements:

New standards relevant to the Company

IFRS 8 "Operating Segments" introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Company's 2010 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Company's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. Currently the Company considers revenues to be generated via a single business segment (see Note 2).

Amended standards relevant to the Company

Revised IAS 1 "Presentation of Financial Statements" (2007) introduces the term total comprehensive income, which represents changes in equity during a period other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income may be presented in either a single statement of comprehensive income (effectively combining both the income statement and all non-owner changes in equity in a single statement), or in an income statement and a separate statement of comprehensive income. Revised IAS 1, which becomes mandatory for the Company's 2010 financial statements, is expected to have a significant impact on the presentation of the financial statements. The Company plans to provide total comprehensive income in a single statement of comprehensive income for its 2010 financial statements.

Amendment to IFRS 2 "Share-based Payment – Vesting Conditions and Cancellations" clarifies the definition of vesting conditions; introduces the concept of non-vesting conditions; requires non-vesting conditions to be reflected in grant-date fair value; and provides the accounting treatment for non-vesting conditions and cancellations. The amendments to IFRS 2 will become mandatory for the Company's 2010 financial statements, with retrospective application and is not expected to have a significant impact on the financial statements.

Notes *(continued)*

1 Accounting policies *(continued)*

Revenue

Revenue comprises income derived from the supply of carbon fibre structures and carbon fibre reinforced ceramic products. Revenue is recognised on transfer to the customer of significant risks and rewards of ownership, generally this will be when goods are despatched to the customer. Turnover excludes value added taxes.

Contractual arrangements exist with specific customers which set selling prices and target volumes for future periods. The revenue derived from specific purchase orders raised against these contracts is recognised in a consistent manner to that described above

Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Trade and other receivables

Trade and other receivables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses.

Trade and other payables

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Interest rate risk

The Company finances its operations through cash. Cash resources are invested to attract the highest rates for periods that do not limit access to these resources.

Liquidity risk

With regard to liquidity, the Company's policy has throughout the year been to ensure that the Company is able at all times to meet its financial liabilities as and when they fall due.

Critical accounting estimates and judgements

The preparation of financial statements in conformity with adopted IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not already apparent from other sources. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to carrying amount of assets and liabilities within the next financial year are discussed below:

Impairment of property, plant and equipment
Property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate that the carrying amount of an asset is not recoverable.

Provision to write inventories down to net realisable value
The Company makes provisions for obsolescence based on historical experiences and management estimates of future events. Actual outcome could vary significantly from these estimates

Research and development expenditure
The board considers the definitions of research and development costs as outlined in *IAS 38: Intangible assets* when determining the correct treatment of costs incurred. Where such expenditure is technically and commercially feasible, the Company intends and has the technical ability and sufficient resources to complete development, future economic benefits are probable and if the Company can measure reliably the expenditure attributable to the intangible asset it is treated as development expenditure and capitalised on the balance sheet.

Notes *(continued)*

1 Accounting policies *(continued)*

In considering whether an item of expenditure meets these criteria, the Board applies judgement. During the year all such expenditure has been expensed to the income statement on the grounds that it relates to feasibility studies to identify new applications for the technology or methods of improving the production process. As the technical feasibility of this work is unknown at the time the costs are incurred, none meet the criteria for capitalisation during the current or previous year.

2 Analysis of turnover

Revenue and loss on ordinary activities before taxation is wholly attributable to the principal activity of the Company, namely the development and manufacture of reinforced ceramic products. As all products are similar in nature and are manufactured using a single production facility, the board have reassessed the segmental breakdown of the business during the year and consider that all revenue falls under a single business segment as defined by IAS 14.

The following additional information is presented solely to assist the reader in understanding the performance of the Company in the year.

Revenue by type of end user is analysed as follows:

	2009	2008
	£	£
Automotive	**241,157**	345,464
Defence and aerospace	**236,279**	83,798
Automotive Racing	**201,848**	78,850
	679,284	508,111

All sales are serviced by a single production facility. As such, net assets, liabilities, additions to property, plant and equipment, loss before tax and depreciation cannot be attributed to specific categories.

Revenue by geographical destination is analysed as follows:

	2009	2008
	£	£
By geographical market:		
United Kingdom	**296,821**	138,074
Rest of Europe	**375,365**	353,964
United States of America	**7,098**	16,073
	679,284	508,111

Revenue by origin, net assets and profit before interest and tax all relate to the UK.

Notes *(continued)*

3 Expenses and auditors remuneration

	2009	2008
	£	£
Operating loss before taxation is stated		
after charging		
Depreciation of owned tangible fixed assets	**71,282**	49,079
Research and development expensed as incurred	**839,509**	678,078
Amortisation of patents and licences	**-**	1,886
Rents payable under operating leases – land and buildings	**53,577**	50,251
Exchange losses	**5,609**	2,294
after crediting		
Exchange gains	**3,831**	2,164
Government grants	**166,035**	220,652

Audit of these financial statements

Amounts receivable by auditors and their associates in respect of:

Audit of financial statements pursuant to legislation	**17,450**	17,450

Government grants

Grants received comprise revenue grants from DTI.

These are subject to making expenditure as stipulated in the grant applications and to audit of the claims. There are no unfulfilled conditions or contingencies associated with government assistance received.

4 Remuneration of directors

The company considers key management personnel as defined in IAS 24 "Related party disclosures" to be the directors of the company. The aggregate amount of emoluments paid to directors in respect of qualifying services during the year was £233,198 *(2008: £231,644)*. Of this, £115,912 *(2008: £84,399)* was made to the highest paid director and company pension contributions of £4,667 *(2008: £3,898)* were made to a money purchase scheme on his behalf.

Full disclosure of directors' emoluments, share options and directors' pension entitlements which form part of the package as well as remuneration and transactions is given in the Report on directors' remuneration on pages 9 and 10.

Notes *(continued)*

5 Staff numbers and costs

The average number of persons employed by the Company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2009	2008
Directors	**6**	6
Other employees	**17**	14
	23	20

The aggregate payroll costs of these persons were as follows:

	2009	2008
	£	£
Wages and salaries	**609,510**	624,013
Social security costs	**72,308**	61,685
Other pension costs (see note 16)	**29,429**	19,497
	711,247	705,195

6 Financial income and expenses

Financial income	**2009**	2008
	£	£
Bank interest receivable	**20,646**	67,347

Financial Expenses	**2009**	2008
	£	£
Total interest expense on financial liabilities measured at amortised cost	**1,854**	-

Notes *(continued)*

7 Taxation

Analysis of credit in year

	2009	2008
	£	£
UK corporation tax		
Research and development tax repayment	**(150,845)**	(156,394)
Income tax credit	**(150,845)**	(156,394)

Details of the unrecognised deferred tax asset are included in note 13.

Factors affecting the tax credit for the current period

The current tax credit for the year is lower *(2008: lower)* than the standard rate of corporation tax in the UK of 28% *(2008: 28%)*. The differences are explained below:

	2009	2008
Reconciliation of effective tax rate	**£**	£
Loss for the year	**(840,740)**	(594,065)
Total income tax credit	**(150,844)**	(156,394)
Loss excluding income tax	**(991,584)**	(750,459)
Current tax at average rate of 28.00% *(2008: 29.67%)*	**(277,644)**	(222,661)
Effects of:		
Non-deductible expenses	**359**	632
Reduction in tax rate	**-**	38,861
Change in unrecognised timing differences	**42,306**	4,976
Current year losses for which no deferred tax recognised	**234,979**	178,192
Tax incentives	**(150,845)**	(156,394)
Income tax credit (see above)	**(150,845)**	(156,394)

Factors that may affect future tax charges

The effective tax rate in future years is expected to be below the standard rate of corporation tax in the UK due principally to historical losses which have been carried forward.

Notes *(continued)*

8 Property, plant and equipment

	Assets in the course of construction	Leasehold improvements	Plant and machinery	Fixtures and fittings	Motor vehicles	Total
	£	£	£	£	£	£
Cost						
At 1 June 2007	44,216	47,315	448,058	29,445	28,660	597,694
Additions	-	16,453	118,687	7,459	-	142,599
Disposals and write offs	-	-	(203,290)	(7,335)	-	(210,625)
At 31 May 2008	44,216	63,768	363,455	29,569	28,660	529,668
Additions	-	10,852	45,873	14,703	-	71,428
Disposals and write offs	-	-	-	-	(28,660)	(28,660)
At 31 May 2009	44,216	74,620	409,328	44,272	-	572,436
Depreciation						
At 1 June 2007	44,216	1,454	233,584	12,502	16,483	308,239
Disposals and write offs	-	-	(203,290)	(7,335)	-	(210,625)
Charge for year	-	5,557	31,582	4,775	7,165	49,079
At 31 May 2008	44,216	7,011	61,876	9,942	23,648	146,693
Disposals and write offs	-	-	-	-	(27,985)	(27,985)
Charge for year	-	7,068	50,826	9,051	4,337	71,282
At 31 May 2009	44,216	14,079	112,702	18,993	-	189,990
Net book value						
At 1 June 2007	-	45,861	214,474	16,943	12,177	289,455
At 31 May 2008	-	56,757	301,579	19,627	5,012	382,975
At 31 May 2009	**-**	**60,541**	**296,626**	**25,279**	**-**	**382,446**

At 31 May 2009 the net carrying amount of leased plant and machinery was £44,298 (2008: £ nil)

9 Inventories

	2009	2008
	£	£
Raw materials and consumables	**27,249**	28,059
Work in progress	**201,002**	230,815
	228,251	258,874

Raw materials, consumables and changes in finished goods and work in progress recognised as cost of sales in the year amounted to £282,487 *(2008 £252,874)*

Notes *(continued)*

10 Trade and other receivables

	2009	2008
	£	£
Trade receivables	**68,626**	160,954
Other receivables	**83,695**	86,475
Prepayments and accrued income	**60,530**	45,494
	212,851	292,923

All receivables fall due within one year.

11 Other interest-bearing loans and borrowings

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Company's exposure to interest rate and foreign currency risk, see note 19.

	2009	2008
	£	£
Current liabilities		
Current portion of finance lease liabilities	**14,438**	-
Non-current liabilities		
Finance lease liabilities	**18,195**	-

Finance lease liabilities are payable as follows:

	Future minimum lease payments 2009 £000	**Interest 2009 £000**	**Present value of minimum lease payments 2009 £000**	**Future minimum lease payments** 2008 £000	**Interest** 2008 £000	**Present value of minimum lease payments** 2008 £000
Less than one year	**16,684**	**2,246**	**14,438**	-	-	-
Between one and five years	**19,208**	**1,013**	**18,195**	-	-	-
More than five years	-	-	-	-	-	-
	35,892	**3,259**	**32,633**	-	-	-

Notes *(continued)*

12 Trade and other payables: amounts falling due within one year

	2008	2008
	£	£
Trade payables	**77,634**	171,620
Taxation and social security	**30,209**	19,723
Accruals and deferred income	**60,826**	83,309
	168,669	274,652

13 Deferred tax

The elements of deferred taxation are as follows:

	2009	2008
	£	£
Difference between accumulated depreciation and amortisation and capital allowances	**34,441**	17,810
Other short term timing differences	**(1,738)**	(2,572)
Tax losses	**(625,883)**	(566,180)
Unrecognised deferred tax asset	**(593,180)**	(550,942)

The Company has an unrecognised deferred tax asset at 31 May 2009 of £593,180 *(2008: £550,942)* relating principally to tax losses which the company can offset against future taxable profits from the same trade

The deferred tax asset has not been recognised in the accounts because it is not possible to assess whether there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

14 Called up share capital

	2009	2008
	£	£
Authorised		
20,000,000 ordinary shares of £0.01 each	**200,000**	200,000
Allotted, called up and fully paid		
19,030,748 shares of £0.01 each	**190,308**	190,308

Notes *(continued)*

14 Called up share capital *(continued)*

Enterprise Management Incentive Scheme

The Company operates a share incentive scheme for the benefit of the directors and certain employees. All options are granted at the discretion of the Board. The scheme grants options to purchase ordinary shares of £0.01 each. No options were exercised in the period.

The options granted to directors, date of grant and exercise price and exercise periods under the scheme are set out in the report on directors' remuneration on pages 9 and 10. In addition to the directors' share options, certain employees have been granted the following options:

Date of grant	Number of unexpired share options at year end	Exercise price	Exercise period
18/04/2007	170,000	£0.21	18/04/10-18/04/17
30/06/2008	151,200	£0.1825	30/06/11-30/06/18
22/09/2008	575,839	£0.1850	22/09/11-22/09/18

There are a total of 897,039 unexpired options held by employees and a total of 1,106,926 unexpired options held by directors.

15 Share premium and reserves

	Share premium account	Capital reserve	Profit and loss account
	£	£	£
At 1 June 2007	4,902,715	463,885	(4,093,850)
Retained loss for the year	-	-	(594,065)
Share Issue	847,237	-	-
Reversal of charge in relation to share based payments	-	-	56,609
At 31 May 2008	5,749,952	463,885	(4,631,306)
Retained loss for the year	-	-	(840,740)
Reversal of charge in relation to share based payments	-	-	94,424
At 31 May 2009	5,749,952	463,885	(5,377,622)

16 Pension scheme

The Company contributes to specific employees' personal pension schemes. The pension cost charge for the year represents contributions payable by the Company to the scheme and amounted to £29,429 *(2008: £19,497)*.

There were outstanding contributions of £nil *(2008:£nil)* at the end of the financial year.

17 Related party disclosures

The results of the Company include no material transactions with related parties in the current or preceding year.

Notes *(continued)*

18 Loss on ordinary shares

The calculation of basic loss per ordinary share is based on the loss for the financial year divided by the weighted average number of shares in issue during the year.

Losses and number of shares used in the calculations of loss per ordinary share are set out below:

Basic

	2009	2008
	£	£
Loss after tax	**(840,740)**	(594,065)
Weighted average number of shares	**19,030,748**	17,828,562
Loss per share	**(4.42p)**	(3.33p)

The calculation of diluted loss per ordinary share is identical to that used for the basic loss per ordinary share. This is because the exercise of options would have the effect of reducing the loss per ordinary share from continuing operations and is therefore not dilutive under the terms of IAS33.

19 Derivatives and other financial instruments

The Company's policies with regard to financial instruments are set out within the accounting policies note. The risks arising from the Company's financial assets and liabilities are set out below with the policies for their respective management.

Currency Risk

The Company transacts business in foreign currencies and therefore incurs some transaction risk.

The Company had no open foreign exchange contracts at the Balance Sheet date.

The Company's exposure to foreign currency risk was as follows, this is based on the carrying amount for monetary financial instruments:

		31-May-09			31-May-08	
	US Dollar	**Euro**	**Sterling**	US Dollar	Euro	Sterling
	£	**£**	**£**	£	£	£
Cash and cash equivalents	-	-	**404,275**	-	-	1,112,719
Trade receivables	-	**43,267**	**25,359**	-	56,803	104,151
Trade payables	**(1,987)**	**(924)**	**(74,723)**	(19,531)	-	(152,089)
Finance lease liabilities	-	-	**(32,633)**	-	-	-
Net Exposure	**(1,987)**	**42,343**	**322,278**	(19,531)	56,803	1,064,781

	Average Rate		**Reporting Date Spot Rate**	
	2009	**2008**	**2009**	**2008**
US Dollar	1.643	2.006	1.619	1.976
Euro	1.182	1.385	1.145	1.273

Notes *(continued)*

19 Derivatives and other financial instruments *(continued)*

Sensitivity Analysis

A ten percent strengthening of the pound against the US Dollar and the Euro at 31 May 2009 would have (decreased)/increased profit by the amounts below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2008.

	US Dollar	**Euro**
	£	£
31 May 2009	(180)	3850
31 May 2008	(1780)	5160

A ten percent weakening of the pound against the US Dollar and the Euro at 31st May 2009 would have an equal and opposite effect to the amounts shown above, on the basis all other variables remain constant.

Price Risk

The Company aims to minimise its exposure to supplier price increases and customer price decreases by offsetting reciprocal supplier and customer arrangements.

Credit Risk

The Company operates a closely monitored collection policy.

The ageing of trade receivables at the reporting date was

		31-May-09			**31-May-08**	
	Gross	**Impairment**	**Net**	**Gross**	**Impairment**	**Net**
	£	£	£	£	£	£
Not past due	21,787	-	21,787	151,381	-	151,381
Past due 0 to 30 days	-	-	-	9,264	-	9,264
Past due 31 to 90 days	46,839	-	46,839	5,105	(4,796)	309
	68,626	-	68,626	165,750	(4,796)	160,954

The majority of the debt falling in 31 to 90 days at 31 May 2009 relates to one customer for whom trading terms have been re-negotiated. This customer has adhered to these revised terms since re-negotiation and as such no impairment of this receivable is deemed necessary.

The movement in the allowance for impairment in respect of trade receivables was as follows:

	Impairment Allowance
	£
Balance 1 June 2007	9,499
Impairment loss recognised	(4,703)
Balance 31 May 2008	4,796
Impairment loss recognised	(4,796)
Balance 31 May 2009	-

Notes *(continued)*

19 Derivatives and other financial instruments *(continued)*

Liquidity Risk

The Company's objective is to maintain a balance between continuity and flexibility of funding through the use of short term deposits.

The contractual maturity of all cash and cash equivalents, trade and other receivables at the current and preceding balance sheet date is within one year.

The contractual maturity of trade and other payables at the current and preceding balance sheet date is within three months.

The contractual maturity of finance lease liabilities can be found in note 11

Interest Rate Risk
At the balance sheet date the interest rate profile of the Company's interest-bearing financial instruments was

	2009	2008
	£	£
Fixed rate instruments		
Finance lease liabilities	**32,633**	-

The Company has cash deposits of £398,780 *(2008: £1,039,603)*.These funds are placed on premium rate deposit at rates which tracks bank base rate. These deposits are reviewed at least every 30 days. These funds are available on demand. At the year end, the weighted average interest rate for the floating rate cash deposits was the Barclays base rate of 0.50% *(2008: 5.49% HBOS)*.

Fair values of the Company's financial assets and liabilities

Trade and other receivables

The fair value of trade and other receivables, is estimated as the present value of future cash flows, discounted at the market rate of interest at the balance sheet date if the effect is material.

Trade and other payables

The fair value of trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the balance sheet date if the effect is material.

Cash and cash equivalents

The fair value of cash and cash equivalents is estimated as its carrying amount, all cash and cash equivalents are repayable on demand.

Notes *(continued)*

19 Derivatives and other financial instruments *(continued)*

Interest-bearing borrowings

Fair value, which after initial recognition is determined for disclosure purposes only, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the balance sheet date if the effect is material.

The fair value of financial assets and liabilities, together with the carrying amounts shown in the balance sheet are as follows:

	2009		2008	
	Carrying value	Fair value	Carrying value	Fair value
	£	£	£	£
Financial assets:				
Cash and cash equivalents	404,275	404,275	1,112,719	1,112,719
Loans and receivables:				
Trade receivables	68,626	68,626	160,954	160,954
Total financial assets	472,901	472,901	1,273,673	1,273,673
Financial liabilities at amortised cost				
Trade payables	(77,634)	(77,634)	(171,620)	(171,620)
Finance Lease Liabilities	(32,633)	(32,633)	-	-
Total financial liabilities	(110,267)	(110,267)	(274,652)	(274,652)

20 Commitments

Total future minimum commitments under non-cancellable operating leases are as follows:

	Land and buildings 2009	Motor Vehicles	Land and buildings 2008	Motor Vehicles
	£	£	£	£
Operating leases which expire:				
Within one year	-	-	-	-
In the second to fifth years inclusive	174,103	28,635	183,509	-
	174,103	28,635	183,509	-

Notes *(continued)*

21 Share based payments

Share Options

The number of options outstanding under the Company's share option scheme is as follows:

Number of Share Options - Ordinary Shares at 1p

Note	At 31 May-08	Granted	Surrendered	Lapsed	At 31 May-09	Exercise price	Date from which exercisable	Expiry date
(a)	158,873	-	(78,858)	(80,015)	-	70p	19/12/2005	19/12/2012
(a)	34,091	-	(34,091)	-	-	88p	08/12/2006	08/12/2013
(a)	60,000	-	(40,000)	(20,000)	-	66.5p	08/03/2007	08/03/2014
(a)	85,000	-	(70,000)	(15,000)	-	50p	04/04/2008	04/04/2015
(a)	424,000	-	(424,000)	-	-	40p	14/09/2008	14/09/2015
(a)	314,125	-	-	(25,000)	289,125	21p	18/04/2010	18/04/2017
(b)	110,875	-	-	-	110,875	21p	18/04/2010	18/04/2017
(a)	-	479,200	-	(17,000)	462,200	18.25p	30/06/2011	30/06/2018
(b)	-	63,000	-	-	63,000	18.25p	22/09/2011	22/09/2018
(a)	-	865,327	-	-	865,327	18.5p	30/06/2011	30/06/2018
(b)	-	213,438	-	-	213,438	18.5p	22/09/2011	22/09/2018
	1,186,964	1,620,965	(646,949)	(157,015)	2,003,965			

(a) These options have been granted under the EMI approved scheme. There have been no variations to the terms and conditions or performance criteria attached to these share options during the financial year. There are no performance conditions attached to these shares other than continued employment by the Company.

(b) These options have been granted under the unapproved scheme. There have been no variations to the terms and conditions or performance criteria attached to these share options during the financial year. There are no performance conditions attached to these shares other than continued employment by the Company.

There was no cost payable by the employees on the grant of any of the above options.

The option holder may only exercise his options during employment with the Company.

The movements of the EMI and unapproved share options outstanding are shown overleaf:

Notes *(continued)*

21 Share based payments *(continued)*

	EMI Scheme		Unapproved Scheme	
	Number of awards	Weighted Average Exercise Price £	Number of awards	Weighted Average Exercise Price £
Outstanding at 01 June 2007	1,148,232	0.43	110,875	0.21
Forfeited	(72,143)	0.47	-	-
Outstanding at 31 May 2008	1,076,089	0.41	110,875	0.21
Granted	1,344,527	0.18	276,438	0.18
Forfeited & Surrendered	(803,964)	0.50	-	-
Outstanding at 31 May 2009	1,616,652	0.41	387,313	0.21
Exercisable at 31 May 2009	-	-	-	-
Range of exercise prices	18.25p to 21p		18.25p to 21p	
Weighted average remaining contractual life	9 years 0 months		8 years 11 months	

There were no share options exercised during the year *(2008 nil)*.

A charge of £94,424 *(2008: £56,609)* has been made in the profit and loss account to spread the fair value of the options over the 3 year service obligations of those incentives.

Assumptions used in the valuation of share based options.

In calculating the fair value of the share based payment arrangements the Company has used the Black Scholes method. The fair value of the share options granted in 2009 and the assumptions used of their fair value on the date of grant were as follows:

Weighted Average Assumptions	2009	2008
Fair Value per share option	**14.83p**	N/a*
Share price on date of grant	**18.42p**	N/a*
Exercise Price	**18.42p**	N/a*
Share options granted in the year EMI	**1,344,527**	N/a*
Share options granted in the year Unapproved	**276,438**	N/a*
Expected Volatility	**100%**	N/a*
Exercise Pattern (years)	**3-10 years uniformly**	N/a*
Expected dividend yields	**0%**	N/a*
Risk free rate of return	**5%**	N/a*

Notes *(continued)*

21 Share based payments *(continued)*

The fair value of the share options is applied to the number of options that are expected to vest which takes into account the expected and actual forfeitures over the vesting period as a result of cessation of employment.

Expected volatility was determined by assessing the Company's historic data and the market the Company operates in.

22 Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board of directors monitors the return on capital, defined as net operating income divided by total shareholders' equity.

At present employees and directors would hold 18% of the share capital, following the exercise of all outstanding share options.

23 Post balance sheet events

To facilitate the management of the operations and to ensure its core Intellectual Property (IP) is fully protected, the Company has created 4 wholly owned operating subsidiaries. The IP and the management is held within the Group plc company and the technology is licensed down to each subsidiary.

Company information and advisers

Websites	www.surface-transforms.com and www.systemsST.com
Registered Number	03769702
Directors	Kevin D'Silva *(Non-executive Chairman)* Dr Kevin Johnson *(Managing Director)* Geoffrey Gould *(Sales and Marketing Director)* Professor David Thomas Clark *(Non-executive Director)* Kenneth Michael Baker *(Non-executive Director)*
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Brokers	Seymour Pierce Limited 20 Old Bailey London EC4M 7EN
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Solicitors to the Company	Halliwells LLP 3 Hardman Square, Spinningfields, Manchester, M3 3EB
Bankers	Barclays Bank plc 125 Main Street Frodsham Cheshire WA6 7AD Bank of Scotland Plc The Mound Edinburgh EH1 1YZ
Registrars	Capita IRG plc Bourne House 34 Beckenham Road Beckenham Kent BR3 4TU