COMPANY NO 05560820

CMR Fuel Cells plc

(Formerly known as CMR Fuel Cells Limited and Law 2435 Limited)

Annual Report

For the year ended to 31 December 2006

Contents

Chairman's Statement

2006 Highlights

- Technical performance milestones met successfully in line with timescales and ahead of budget anticipated in the Company's AIM admission document
- Commercial relationships progressing well with leading consumer electronics OEMs
- Entered into porous MEA development program with Solvay SA
- Significant strengthening of commercial team with recruitment of Chief Commercial Officer
- Appointment of Tim Curtis to the Board as Non-Executive Director
- Staff numbers up to 27
- Core patent granted in China - a key market
- Entered into 2nd generation 'printed stack' collaboration with Xaar plc and Solvay SA
- Strong cash position

It is with great pleasure that I make my first full report as the Chairman of the Company During 2006, CMR Fuel Cells plc ("CMR") grew significantly in terms of resources and capability and I am pleased to report that we have made excellent progress in line with the objectives set out during the Company's placing and admission to AIM in December 2005

The past year has seen sustained market interest for small, long-running portable fuel cells and we expect that methanol powered fuel cells will continue to be seen as the next generation of power source for a wide range of portable electronics products CMR remains committed to delivering the low cost, high performance fuel cell stacks that will enable the mass-market deployment of fuel cell power sources

During the twelve month period, the adjusted loss before tax (that is, loss before tax adjusted for the cost of share options) was £1 30 million (2005 £0 53m), reflecting the budgeted increased level of development activity during 2006 The increased activity has required additional technical staff, equipment and space, the expenditure on which was in line with budget At the Balance Sheet date, staff numbers had risen to 27 in total from 11 at the beginning of the period

At 31 December 2006, net current assets totalled £10 59m (2005 £12 36m), of which £10 58m was held in cash and short term deposits (2005 £12 64m) Whilst technical progress has been in line with expectation we enter the coming financial year with better cash reserves than we had anticipated which puts us in a good financial position from which to achieve CMR's objectives

In accordance with the dividend policy disclosed at the time of the IPO, the Board is not recommending payment of a dividend

In 2006, I was able to report significant growth in our commercial team with the appointment of an experienced Chief Commercial Officer and representation in Japan This improved our ability to service and develop our commercial relationships and we are continuing to gain stronger traction with existing and new partners in Asia We have successfully delivered evaluation units to our Korean partner and we are well on track to enter into a formal agreement to jointly develop a stand alone demonstrator based on a CMR stack with this partner

Chairman's Statement (continued)

Our technical team has continued to make excellent progress – we have recently announced fuel cell stacks with power densities of over 500 Watts per litre Growing technical capability allied with our purpose fitted facilities enable us to consistently produce world class fuel cell components This allows CMR to evaluate parallel technology and fabrication themes, based upon the mixed reactant concept, giving us maximum flexibility to meet our customer's needs by optimising the ultimate balance between cost and performance We will inevitably have additional technical issues to solve on the path to commercial production but we believe that the progress made in building our technical infrastructure in 2006 leaves us far better positioned to face these challenges as they occur

Our credibility with potential customers and suppliers alike has grown strongly and we now have well developed supplier relationships which are vital for us to offer our customers a complete supply chain

We are acutely aware that not only must we have commercially compelling first generation products, but also we need a strong road-map to ensure our competitive position is maintained going forwards To this end, CMR entered into a non-exclusive collaboration with inkjet printing specialist, Xaar plc, and international chemicals group, Solvay SA to jointly develop a single-step production process for the mass-manufacture of entire fuel cell stacks based around CMR's unique and patented fuel cell architecture This is a long term programme which we believe could form the basis of CMR's second generation products

In December we welcomed Tim Curtis onto our board and we look forward to benefiting from his extensive experience in taking high-growth technology businesses like CMR from the development phase into commercial production Tim's advice will be of real value as we look to crystalise the opportunities that arise from our commercial efforts

We continue to develop and maintain our intellectual property and, in addition to our existing patents in Australia and China, we expect to announce further patents being granted over the coming year In developing our products, our science and engineering teams have identified new and valuable intellectual property, leading to some sixteen new UK patent applications in 2006

Outlook

CMR's objectives for the coming year are to

- Progress and deepen the customer-side commercial relationships we currently have
- Develop new commercial relationships – both supplier and customer side
- Broaden development of our technology in line with planned timescales
- Successfully complete joint development and demonstration projects to support progression of commercial relationships
- Progress the current intellectual property portfolio and capture new intellectual property

Finally I would like to thank all our staff for their commitment, innovation and hard work that has produced the sustained progress that is central to the success of the business and I look forward to reporting on their continued success throughout the coming year

Gordon Crawford
Chairman

Chief Executive's Statement

At the time of our listing on the AIM market in December 2005, CMR identified four key areas of focus – commercial engagement, technical progression, intellectual property development and corporate development I am very pleased to be able to report that we have achieved excellent results in all of these areas and that we expect to be able to maintain this level of progress throughout 2007

At a headline level, our development team doubled the power density of our fuel cell stacks from 250 watts per litre to over 500 watts per litre, in accordance with the target outlined in the Company's AIM Admission Document, but this is not the whole story As well as increasing the power density we have also significantly improved the selectivity of our MEAs by incorporating an improved non-platinum catalyst and our fuel cell component development facility has also enabled us to increase repeatability of our MEAs - both key parameters for our customers We now have a world-class development team which commands the respect of many industry leaders and gives us value-adding partnership opportunities which we could not have contemplated a year ago

Our technical team remains commercially focussed and we expect to be addressing other commercially relevant parameters such as cost and efficiency over the coming year Additionally, our growing 'know-how' allows us to identify new and better ways of solving problems and we will continue to review and apply improved ways of achieving our goals

On the commercial front, our relationships in Asia continue to develop and with the recruitment of our Chief Commercial Officer, we have been able to devote more time and attention to developing these Asia continues to be the most active region as far as portable fuel cells are concerned and we will continue to focus here – especially Korea and Japan

Market interest in portable fuel cells remains high, with laptop computers and electric scooters continuing to be reported at the top of the list of likely mass-market applications It is very difficult to forecast exactly when mass market opportunities for fuel cells will open up, but the growing number of niche products coming on to the market and growing availability of fuel cell 'building blocks' gives us confidence that the portable fuel cell market will be one of the first to emerge

CMR is the UK's only developer of direct methanol fuel cell stacks and one of only a handful of such companies in the world This places us well to exploit the consumer electronics market where methanol fuel cells could be the single largest fuel cell related application sector for the next twenty years

To be successful, we recognise the need to have a complete supply chain and to have a clear road-map of products going forwards To support these objectives, we have been successful in building relationships with sector leading partners Over 2006 we announced agreements with Solvay, XAAR and ASPECT and we will be announcing others over the coming year

Our extensive knowledge of fuel cell technology and markets has lead to CMR's role as industrial advisor to several national fuel cell programmes including NPL and the bio-fuel cell consortium, our executive committee role in Fuel Cells UK, membership & contribution to Intel's EBLWG and we have been invited by DTI to be the UK's representative to the EU working group on portable fuel cells

CMR's formal intellectual property has developed well over 2006 – as well as patent grants in China and Australia, we have pushed forwards with our applications in other territories We expect to be able to announce patents moving to granted status in some of these territories over the coming year We have seen a growing level of interest in the 'mixed reactant, flow through' mode of fuel cell operation and we will continue to be vigilant in identifying and addressing potentially conflicting patent filings

Cash resources continue to be managed carefully and we have been able to operate well within budget It was anticipated at the beginning of the period that the Group would spend £4 6m in financing operations and capital expenditure over the year, but in fact achieved a spend of £2 6m

As anticipated in CMR's last interim report, we have now completed our executive team and I am pleased to report that the team has performed very well – over 2006 it delivered results on time, within budget and on plan I am extremely pleased to have such high capability resources available to the Company and I am confident that we will be able to continue to report good progress over the coming year

John Halfpenny
Chief Executive Officer

Financial Review

Loss before interest and tax

The results are presented for the year ended 31 December 2006, the first full year of trading since the Company floated on AIM in December 2005

The results have been prepared using merger accounting principles - the investment is recorded in the Company's balance sheet at the nominal value of the shares issued together with the fair value of any additional consideration paid In the Group financial statements, merged subsidiary undertakings are treated as if they had always been a member of the Group The results of such a subsidiary are included for the whole period in the year in which it joins the Group The corresponding figures for the previous year include its results for that period, the assets and liabilities at the previous balance sheet date and the shares issued by the Company as consideration as if they had always been in issue Any difference between the nominal value of the shares acquired by the Company and those issued by the Company to acquire them is taken to reserves The financial statements for the year ended 31 December 2006 have been prepared on a proforma basis in accordance with merger accounting principles

Loss before interest and tax for the year was £2 0m (2005 £0 9m) Adjusted loss before interest and tax for the year (loss on ordinary activities before tax after adjusting for share option costs) was £1 3m which was below the Company's internal expectations for the period There was no turnover in the year

Interest

Interest of £523,000 (2005 £52,000) was received in the year on average cash balances of £11 4m

Cash

The Company utilised funds of £2 1m during the year, resulting in total funds of £10 6m at the Balance Sheet date

Tax

Tax losses of £323,000 have been carried forward, and there is no charge to corporation tax in the year No deferred tax asset has been recognised in the Balance Sheet however due to the uncertainty of future profits at this stage

Dividends

As anticipated in the Admission Document in December 2005, the Company is not currently proposing to pay a dividend

Board of Directors

Gordon Crawford
Non-executive Chairman (age 51)

Gordon Crawford was chairman of banking software company London Bridge Software Holdings plc from 1987, through its flotation in 1997, up to its sale to Fair Isaac, a major US corporation in May 2004 Mr Crawford was also a non-executive director of The Innovation Group plc and a non-executive director of Intec Telecom Systems plc, with activities internationally in insurance and telecommunications Mr Crawford is now a non-executive director of Revera Asset Management with a focus on companies at the early stage of their development cycle and non-executive chairman of Honiton Energy Limited, a company developing wind farms in Inner Mongolia

Prof Gordon Edge
Non-executive director (age 69)

Professor Edge is one of the leading business and technology figures in Britain Gordon is a Chartered Engineer (CEng), a Member of the Institution of Electrical Engineers (MIEE), and a Fellow of the Royal Swedish Academy of Engineering Sciences (IVA) He is a member of the Advisory Board of Cambridge University, Department of Materials Science, The Cambridge University - MIT Institute and The Cambridge University Technology Transfer Group

Tim Curtis
Non-executive director (age 64)

Tim Curtis was Chief Executive, from 1992-2004, of Telemetrix plc, an LSE-quoted manufacturer of analogue semiconductors and portable telecommunications test equipment Previously, Tim worked for and was a Main Board Director of Unitech plc, a broadly-based manufacturer and distributor of electronic equipment and components Tim is currently Chairman of AIM quoted IBS OPENSystems plc, a leading supplier of software systems to UK local government and housing associations, Chairman of RaceCourse Technical Services Ltd and a Non-Executive Director of Herald Investment Trust plc

Tim has a BA from Cambridge University in Economics and has a MBA with distinction from Harvard University, Graduate School of Business Administration Tim was appointed to the Board on 13 December 2006

John Halfpenny
Chief Executive Officer (age 45)

John Halfpenny is an experienced entrepreneur and chartered engineer (CEng) with a successful track record and significant experience in the consumer electronics sector He founded and subsequently sold Micrologic Solutions to ARM plc, Telephone Solutions Ltd, HII Ltd, and Enterprise Network Sciences Ltd to various trade buyers He was director of embedded software at ARM plc and CEO of Splashpower Ltd He started his career with Texas Instruments in 1982

John has a Masters degree from Cambridge University in Engineering Science and is a member of The Institution of Engineering and Technology (MIET)

Michael Priestnall
Chief Technology Officer (age 43)

Michael Priestnall is a co-founder of CMR and previously head of Energy Consulting at the Sagentia Group (formerly the Generics Group) Michael is a senior figure in the fuel cell industry, heading Cookson Group's ceramic fuel cell program in the 1990's, representing the UK at the IEA on fuel cells and helping to found the Grove Fuel Cell Symposium in the late 1980's Michael was a British Gas Research Fellow at Imperial College and has Masters & Bachelors degrees in Energy Engineering and Chemistry from Cranfield, Massachusetts and East Anglia Universities

Company Information

Directors	G Crawford – appointed 2 November 2005 G M Edge – appointed 23 September 2005 J W Halfpenny – appointed 23 September 2005 M A Priestnall – appointed 23 September 2005 T Curtis – appointed 13 December 2006
Secretary	J Stafford
Trading Office	Harston Mill Royston Road Harston Cambridge CB22 7GG Tel + 44 (0)1223 875295 Fax +44 (0)1223 875255
Registered office	35 Hills Road Cambridge CB2 1NT
Registered number	05560820
Auditors	RSM Robson Rhodes LLP Chartered Accountants Daedalus House Station Road Cambridge CB1 2RE
Bankers	Barclays Bank plc Chesterton Road Cambridge
Website	www cmrfuelcells com
Nominated Advisors	Investec plc 2 Gresham Street London EC2V 7QP

Report of the Directors

The directors present their report and the audited financial statements for the year and period ended 31 December 2006

Business review and principal activities

The principal activity of the Group during the year continued to be the development of fuel cell technology As anticipated, the product being developed has not yet reached the revenue generation phase

A review of the results for the year and of future developments in the business is given in the Chairman's statement, Chief Executive's Report, and in the Financial Review, which form part of this Annual Report

Restructuring and basis of preparation

In order to facilitate the successful flotation of the Company's shares on the AIM market, the Group performed a group reorganisation The Company was incorporated on 12 September 2005 under the name of Law 2435 Limited The Company changed its name to CMR Fuel Cells Limited on 17 October 2005 and to CMR Fuel Cells plc on 14 December 2005 On 30 September 2005 the Company acquired the entire share capital of CMR Fuel Cells Limited by means of a share for share exchange

As explained in the Group's accounting policies in note 1 to the financial statements, the financial statements for the year ended 31 December 2006 have been prepared on a proforma basis in accordance with merger accounting principles, that is, as if the Group had been in existence in its current form throughout the current and previous year

Placing and admission to AIM

On 16 December 2005, the Company successfully placed 5,852,273 ordinary shares of 10p each at 176p per share raising £10 3 million gross and £9 3 million net of expenses The Company was admitted to trading on the AIM market of the London Stock Exchange on 16 December 2005

Key performance indicators

The directors consider that at this stage of the Group's development, the key performance indicators to be achievement of significant development milestones and the amount of cash resources utilised in that process Both of these indicators are discussed in detail in the Chief Executive Officer's Report on page 3

Principal risks and uncertainties facing the Group

At the time of the IPO in December 2005 the directors identified a number of risk factors which it was thought might affect the Group's ability to deliver its strategic goals The directors are of the opinion that, in general, the risk factors identified at that time continue to be relevant to the business A list of these risks, which does not purport to be an exhaustive summary of the risks affecting the Group, is given in no particular order of priority and contains risks considered to be outside the control of the directors, is as follows

Short business history and net operating losses

With the Group's short trading history and accumulated operating losses to date, there can be no absolute assurance that the Group will generate significant revenue or move into profitability at any stage nor that the operating losses can be offset against future profits for income tax purposes

Early stage development company

Although the Company has, in the opinion of the directors, made significant strides since the IPO to meet its corporate objectives, the Group's business is still in a relatively early stage of development and has not yet started generating significant revenues The likelihood of the Group's ultimate business success should be weighed against the risks inherent in any business at this stage of its development The Board believes that the composition of the board and senior management is such that the management has considerable collective experience of similar stage businesses to bring to bear and proven management capability in guiding such companies through this phase

Report of the Directors (continued)

Technology

With any new technology, there are risks associated with the individual development and performance of the technology However the Group continues to test its technology rigorously under laboratory conditions and to adapt development procedures accordingly

Competing technologies

There can be no guarantee that the market for the Group's technology will not ultimately be dominated by technologies other than the Group's or that the Group will be able to adapt to changes in or create "leading-edge" technology However, the Group is active in the market place and makes it a priority to make itself aware of current developments in technology elsewhere

Manufacturing

If the Group succeeds in developing a commercially viable product, there is no absolute assurance at this stage that the product can be manufactured in sufficient commercial and cost effective quantities The Group's designated 'Technical Group' was created in order to test for manufacturing ability and is an integral part of the development process

Market acceptance and Customers

Whilst the directors believe a viable market for the Group's products will develop in the future, there can be no assurance that fuel cell technology will succeed as an alternative to conventional or other new products or that potential customers will, when the product is fully developed, select the Group's fuel cell technology for integration into their commercial products To reduce the risk of this happening, the Group is very active in the market and is very focussed on its marketing message - to this end, a highly experienced Chief Commercial Officer was appointed during the year

Intellectual property

The Group's methods of and procedures for protecting the concepts, idea, proprietary know-how and documentation of its proprietary technology may not ultimately afford the Group complete protection and there can be no absolute assurance that others will not obtain access to the Group's know-how or concepts, ideas and documentation It is the Group's Chief Technology Officer's remit to continually monitor the Group's and others' patents for potential conflicts and weaknesses

Commercial Relationships

The success of the Group is dependent on its ability to initiate, develop and maintain beneficial commercial relationships with other parties including OEMs, suppliers of materials, materials improvement technologies, production technologies, sub-contract manufacturers, fuel cell systems integrators and system manufacturers The Group endeavours where possible to cultivate commercial relationships based on mutual respect and equitable economic returns for all parties involved

Additional financing

The Group anticipates that at some point in the future it will require additional funding to develop its technology The risk is always that such funding might not be available at the required time or at an economic price The Group continues to manage its cash resources and review them against its anticipated technological milestones such that any future funding requirements can be managed effectively and in a timely fashion

Regulatory approvals

Failure to implement or delay any regulatory changes as and when they arise may have a material adverse affect on the financial performance of the Company

Dependence on and hiring of key personnel

The directors acknowledge that the Group's continued success is largely dependent on the performance of its key management and technical personnel There can be assurance that the Group will be able to retain or hire necessary personnel However, remuneration packages are set with the intention that they are sufficiently innovative, motivating and rewarding to attract and retain quality staff

Report of the Directors (continued)

Financial instruments

There is a risk that a fall in the interest rate earned on cash deposits will negatively impact on cash flows The directors continue to monitor the Group's financial assets which comprise in the main, cash held on current account and short term deposits and short term debtors, to ensure that the best returns are generated whilst having regard to the Group's on-going working capital requirements

The directors do not consider currency exposure to be a risk to the Group due to the fact that the vast majority of Group transactions are denominated in Sterling

The Group's current policy to engage with customers on the basis that each party pays its own costs means that the Group has no risk associated with recovery of debts The Group's policy towards suppliers is to assess all suppliers as to the likelihood of continuity of supply

Environment

The directors consider that the nature of the Group's business whilst in the current development stage is not inherently detrimental to the environment and that when the Group's activity eventually reaches the anticipated production phase, there will be significant net benefits to the environment as a whole

Employees

The Group places considerable value on the involvement of its employees and they are regularly briefed on the Group's activities through company meetings and seminars The Board acknowledges that the Group's employees are a key asset in the future success of the Group and their retention and motivation is a high priority The Group closely monitors staff attrition rates which it seeks to maintain at current low levels and aims to structure staff compensation packages at competitive rates in order to attract and retain high-calibre personnel All employees are afforded an equal opportunity to progress and develop their careers as the Group grows

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the specific aptitudes of the applicant concerned It is the policy of the Group that the training, career development and promotion of disabled persons, as far as possible, be identical with that of other employees

Research and development

The Group continues to invest heavily in Research and Development expenditure All such expenditure has been expensed as incurred

Dividends

The directors do not propose to pay a final dividend for the year ending 31 December 2006 (2005 nil)

Directors

The present directors of the Company (and the dates of joining if appropriate) are set out on page 5 The directors' interests in the share capital of the Company are set out in the Remuneration Report

Report of the Directors (continued)

Substantial shareholdings

To the best of the Company's knowledge, as at 23 February 2007, interests amounting to 3% or more of the share capital of the Company, were as follows

Shareholder	Number of ordinary shares	Percentage holding of issued share capital
Conduit Ventures Fund	3,401,090	16 8
Carbon Trust Investments Limited	3,401,090	16 8
Sagentia Limited	1,692,040	8 3
(i) Michael Priestnall	1,257,410	6 2
Herald G P Limited	1,084,930	5 3
(ii)Michael Joseph Evans	934,780	4 6
(iii) CF Group Holdings Limited	852,273	4 2

(i) Michael Priestnall is a co-founder and director of the Company
(ii) Michael Evans is a co-founder of the Company and is a member of staff
(iii) Gordon Crawford, a director of the Company, is the sole shareholder of CF Group Holdings Limited

As at 31 December 2006, the quoted mid-market share price of the Company was 164 5p The highest and lowest quoted mid-market price during the year to 31 December was 270p and 150p respectively

Creditor payment policy

The Company's policy is to use its best endeavours to settle with suppliers in accordance with agreed payment terms The average number of days credit taken from trade creditors at 31 December 2006 was 26 days (2005 34 days)

Stakeholder pension

The Company has designated a stakeholder pension scheme to which its employees can contribute The Company has not made any contributions to the stakeholder scheme

Charitable and Political Donations

The Group made no charitable or political donations during the year (2005 £nil)

Statement of directors' responsibilities for the financial statements

The directors are responsible for preparing the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law, the directors have elected to prepare the financial statements in accordance with United Kingdom Accepted Accounting Practice (United Kingdom Accounting Standards and Applicable Law) The financial statements are required by law to 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 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, and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements

Report of the Directors (continued)

The directors are responsible for keeping proper accounting records which 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 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

The directors are responsible for the maintenance and integrity of the corporate and financial information shown on the Company's website Legislation in the UK concerning the preparation and dissemination of financial statements and other information included in the Annual Reports may differ from legislation in other jurisdictions

Disclosure of information to auditors

At the date of making this report each of the Company's directors, as set out on page 5, confirm the following

- so far as each director is aware, there is no relevant information needed by the Company's auditors in connection with preparing their report 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 in order to make himself aware of any relevant information needed by the Company's auditors in connection with preparing their report and to establish that the Company's auditors are aware of that information

Going concern

After due consideration has been given to the accounts, the budgeted costs and cash flow projections, the directors believe that the Company has sufficient resources to continue in operation for the foreseeable future Accordingly, these financial statements have been prepared on a going concern basis

Auditors

RSM Robson Rhodes LLP, the Company's auditors, are willing to continue in office and a resolution to reappoint them as auditors to the Company will be proposed at the forthcoming Annual General Meeting

Annual General Meeting

The Annual General Meeting of the Company will be held at Harston Mill, Royston Road, Harston, Cambridge on 12 March 2007 The Notice of Meeting has been despatched to shareholders separately

By order of the Board

Julian Stafford
Company Secretary

Corporate Governance

Compliance

The directors recognise the value of the Principles of the Combined Code on Corporate Governance ("the Combined Code") Although, as an AIM company, compliance with the Combined Code is not required the Group seeks to apply the Combined Code when practicable and appropriate for a company of its size

The following statement describes how the Group as at 31 December 2006 sought to address the principles underlying the Combined Code

Board composition and responsibility

For the majority of the period, the Board consisted of two executive and one non-executive director and a non-executive chairman In December 2006, Tim Curtis joined the Board to add to the complement of non-executive directors All directors are equally accountable for the proper stewardship of the Group's affairs

In broad terms, the on-going remit of the Board is as follows -

- Approval of the annual report and any statements made therein
- Approval of any significant changes in accounting policies and practices
- Appointment or removal of directors or the Company Secretary
- Approval of the Company's annual budgets and forecasts and ongoing review of Company strategy and performance
- Approval of appointment of senior staff and setting of their remuneration
- Approval of any material expenditure or capital commitments
- Ensure maintenance of robust systems of internal control – including all operating and financial systems through annual review and assessment
- Review of the Board's own effectiveness
- Ensure continued compliance with any regulatory requirements

The non-executive directors have a particular responsibility to scrutinize and assess the strategy proposed by the executive management, to evaluate performance, business risk and the integrity of financial information and controls, and to ensure appropriate remuneration and succession arrangements are put in place for the executive directors

After careful review, giving particular consideration to the provision of the Combined code in respect of the independence of a Chairman, the Board has concluded that all of the non executive directors are independent in character, judgement and opinion There is no senior non-executive director

Chairman's commitments

The commitments of the Chairman outside those relating to the Company are given in detail in the Board of Directors on page 5 The Chairman's commitments have not materially changed during the period

Policy on election

Directors are required to offer themselves for election every 3 years and at least one third of the Board must offer itself for re-election each year

At the forthcoming Annual General Meeting on 12 March 2007, Mr Halfpenny will be offering himself for re-election Messrs Crawford and Curtis, who were appointed by the Board under Article 19 2 of the Articles of Association during the year, retire at the next Annual General Meeting and are offering themselves for election

Board meetings

Eight Board meetings were held during the period The directors' attendance record is as follows -

John Halfpenny	8
Michael Priestnall	7
Gordon Edge	8
Gordon Crawford	8

Corporate Governance (continued)

Audit Committee

The audit committee is chaired by Gordon Edge and comprises Gordon Crawford and Gordon Edge The audit committee determines the terms of engagement of the Group's and Company's auditors and determines, in consultation with the Group and Company's auditors, the scope of audits It receives and review reports from management and the Group's auditors relating to the interim and annual accounts and the accounting and internal control systems in use by the Group The Board has adopted a policy for the periodic review of the auditors' objectivity and independence

The Audit Committee sat twice during the period and was attended by all the non-executive directors as appropriate

The Board considers that given the relative size of the Group and the relative costs and benefits that would ensue, there is no necessity for the Group to operate an internal audit function at this stage

Remuneration Committee

The remuneration committee is chaired by Gordon Crawford and comprises Gordon Crawford, Gordon Edge and Tim Curtis The remuneration committee reviews the scale and structure of both the Executive Directors' and other key employees' future remuneration and the terms of their service agreements with due regard to the interests of shareholders

The Remuneration Committee sat twice during the year and was attended by all the non executive directors as appropriate

Nomination Committee

There is no nomination committee as the appointment of directors is considered to be the responsibility of the Board as a whole

Internal control and risk

The directors are responsible for establishing and maintaining the Group's system of internal control and reviewing its effectiveness By its nature, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss

The Group conducted a Strategic Review during the year in which a full review and evaluation was made of all risks and an assessment made of the Group's internal controls and procedures Corrective actions to mitigate risks identified were implemented, including the introduction of a Risk Register Internal controls and risks are subject to continuous review by senior management and remedial action taken whereever thought necessary

Board effectiveness

For the time being, the Board itself considers its effectiveness, and that of its committees and directors, on an on-going basis It considers this appropriate to a company of this size

Corporate Governance (continued)

Shareholder communication

The Board encourages regular dialogue with the Group's shareholders and has a policy of making itself available to shareholders at the Annual General Meeting to which all shareholders are invited to attend Non executive directors are regularly briefed by executive management on developments within the Group in order to facilitate their continued understanding of the Group's products and processes

Corporate Social Responsibility

The Board recognises that it has a duty to be a good corporate citizen and is conscious that its business processes minimise harm to the environment, contributes as far as is practicable to the local community, and takes a responsible and positive approach to employment practices and employees

Remuneration Report

The directors present the directors' remuneration report for the year ended 31 December 2006 This report has not been prepared in accordance with the Directors' Report Regulations because as an AIM company, CMR Fuel Cells Plc does not fall within the scope of the regulations

Unaudited information

Remuneration policy

Remuneration levels are set by the Remuneration committee in order to attract and retain high calibre directors and staff

Basis salary and benefits

Basic salaries and benefits are reviewed annually The review process is taken after having regard for the development of the Group and contributions that the individual director makes

Executive Directors' service contracts

John Halfpenny entered into a service agreement with the Group dated 1 September 2004 This agreement confirms his appointment as Chief Executive Officer The agreement can be terminated upon six months' notice in writing by either party and includes restrictive covenants relating to the 12 month period after termination of employment and covering non-solicitation of and non-dealing with the Group's clients, non-solicitation of suppliers and non-solicitation of employees and a restricted covenant for a six month period covering non-competition Mr Halfpenny's basic remuneration is £125,000 per annum and he is entitled to receive a bonus as detailed below

Michael Priestnall entered into a service agreement with the Group dated 8 January 2004 This agreement confirms his appointment as Chief Technology Officer The agreement can be terminated upon six months' notice in writing by either party and includes restrictive covenants relating to the 12 month period after termination of employment and covering non-solicitation of and non-dealing with the Group's clients, non-solicitations of its suppliers and non-solicitation of its employees and a restricted covenant for a six month period covering non-competition Mr Priestnall's basic remuneration is £110,000 per annum and he is entitled to receive a bonus as detailed below

Save in respect of contractual notice, holiday pay and any compensation or payments relating to statutory rights, no executive director is entitled under the service agreements to any enhanced benefits or compensation on termination of employment

Bonuses and share options

Any bonuses paid are non-contractual The Company operates an Enterprise Management Incentive and an Unapproved share option scheme through which it grants options pursuant to a policy designed to motivate and incentivise employees and directors Details of options granted to directors and the performance conditions attaching to them are detailed on page 17

Messrs Halfpenny and Priestnall were both entitled to receive a bonus in the year subject to certain performance criteria being met There were two components to the performance criteria, one based on milestones which reflect the delivery of the business plan and the second relating to the performance of the Company's share price The business plan deliverables related payment to the delivery of technology, achievement of budget plans, and commercial milestones being reached These conditions were partially met in the period such that Mr Halfpenny and Mr Priestnall received bonused of £30,000 and £15,000 respectively

Non-executive directors

Non-executive directors receive a fixed fee for their services and are reimbursed all out of pocket expenses incurred in the pursuance of their duties as non-executives The remuneration of the non-executive directors is determined by the board as a whole

Messrs Crawford and Edge became non-executive directors of the Company on 15 December 2005 Mr Curtis only became a non-executive director on 13 December 2006 Their appointments can be terminated on six months' notice in writing by themselves or the Company Mr Edge and Mr Curtis are entitled to a fee for their services Mr Crawford was not entitled to a fee for the first twelve months of his appointment – however his remuneration arrangements going forward are currently being reviewed

Remuneration Report (continued)

Audited Information

Executive directors' remuneration

The total of fees, bonuses and expenses of the directors for the year ended 31 December 2006 was as follows

	Year ended 31 December 2006 £'000	Year ended 31 December 2005 £'000
J Halfpenny	155	82
M Priestnall	125	105
G Edge	20	-
G Crawford	-	-
T Curtis	-	-
	300	187
Fees and expenses	255	175
Bonuses	45	-
Pensions costs – defined contribution schemes	-	12
	300	187
The number of directors accruing pension benefits under defined contribution schemes	-	1

The Company previously operated defined contribution arrangements for the pensions of Michael Priestnall The assets of the schemes were held separately from those of the Company in independently administered funds The amount charged against profits represented the contributions payable to the schemes in the year These arrangements were discontinued after the IPO in December 2005

Directors' shareholdings

The present directors of the Company are set out on page 5 The directors had the following interests in the share capital of the Company as at 31 December 2006 as follows

	31 December 2006 Ordinary 10p shares Number	31 December 2005 or date of appointment Ordinary 10p Shares Number
M A Priestnall	1,257,410	1,257,410
G Crawford *(1)*	852,273	852,273
G M Edge	-	-
J W Halfpenny *(2)*	82,110	82,110
T M Curtis	-	-

(1) CF Group Holdings Limited is the holder of these shares Gordon Crawford is the sole shareholder of CF Group Holdings Limited
(2) John Halfpenny's shares are registered in the name of his wife, Sharen Mary Halfpenny

Remuneration Report (continued)

Directors' interests in share options

The directors of the Company who served in the period had share options in the ordinary share capital of the Company at 31 December as follows

EMI approved share option scheme

	Description	At 1 January 2006	Granted in current year	Lapsed/ Exercised in year	At 31 December 2006	Exercise price per share	Exercise periods
		Number	Number	Number	Number	£	
J W Halfpenny	Ordinary 10p shares	82,110	-	-	82,110	0 0626	1/9/05 – 30/8/14 (i)
J W Halfpenny	Ordinary 10p shares	205,800	-	-	205,800	0 4609	21/7/06 – 20/7/15 *(ii)*
M Priestnall	Ordinary 10p shares	216,930	-	-	216,930	0 4609	21/7/06 – 20/7/15 *(ii)*

Unapproved share option scheme

	Description	At 1 January 2006	Granted in current year	Lapsed/ Exercised in year	At 31 December 2006	Exercise price per share	Exercise periods
		Number	Number	Number	Number	£	
J W Halfpenny	Ordinary 10p shares	789,250	-	-	789,250	0 4609	21/7/06 – 20/7/15 *(ii)*
M Priestnall	Ordinary 10p shares	114,660	-	-	114,660	0 4609	21/7/06 – 20/7/15 *(ii)*

No other directors have been granted share options in the Company or other Group entities

(i) *Options vested on 1 September 2005 and have not yet been exercised As disclosed in the IPO Admission Document in December 2005, there was a restriction on Mr Halfpenny being able to sell any shares he might have held in the Company for a period of twelve months following the IPO*

(ii) *Options vest one third per annum over three years, the first tranche vesting on 1 July 2006, dependent upon continued employment with the Company and agreed performance criteria*

The performance criteria upon which these share options are considered to vest concern the achievement of targets specifically tailored for each individual director The performance criteria cover factors such as the delivery of business and technology plan objectives, satisfactory execution of corporate strategy and objectives, satisfactory motivation of staff and protection and development of the IP portfolio

As at 31 December 2006, the quoted mid-market share price of the Company was 164 5p The highest and lowest quoted mid-market price during the year to 31 December was 270p and 150p respectively

Approval

The Remuneration Report was approved by the board on 28 February 2007 and signed on its behalf by

Gordon Crawford
Chairman

Independent Auditors Report to the Shareholders of CMR Fuel Cells plc

We have audited the financial statements of CMR Fuel Cells Plc for the year ended 31 December 2006 which comprise the consolidated profit and loss account, the consolidated and company balance sheets, the consolidated cash flow statement, the statement of total recognised gains and losses and the related accounting policies and notes These financial statements have been prepared under the accounting policies set out therein We have also audited the information in the Remuneration Report that is described as having been audited

This report is made solely to the Company's shareholders, 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 shareholders 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 shareholders 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, the Directors' Remuneration Report and the Group 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 and the part of the Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 The information in the Report of the Directors includes specific information presented in the Chairman's Statement and the Chief Executive's Report which is cross- referred from the Key Performance Indicators section of the Report of the Directors and the Remuneration Report referenced from the Directors' Section of the Report of the Directors We report to you whether in our opinion the information given in the Report of the Directors 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 also report to you whether in our opinion the other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements The other information comprises only the Report of the Directors, the unaudited part of the Remuneration Report, the Chairman's Statement, the Chief Executive's Statement, the Financial Review and the Corporate Governance Statement We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any other information

Basis of 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 and the part of the Remuneration Report to be audited It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed

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 and the part of the Remuneration Report to be audited 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 and the part of the Remuneration Report to be audited

Independent Auditors Report to the Shareholders of CMR Fuel Cells plc (continued)

Opinion

In our opinion,

- the financial statements give a true and fair view, of the state of affairs of the Group and the Company as at 31 December 2006 and of the Group's loss for the year then ended,
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Report of the Directors is consistent with the financial statements

RSM Robson Rhodes LLP

RSM Robson Rhodes LLP
Chartered Accountants and Registered Auditors
Cambridge, England

28 February 2007

Consolidated Profit and Loss Account

For the year ended 31 December 2006

	Note	2006 £'000	Restated 2005 £'000
Turnover - continuing operations		-	-
Share option costs		(726)	(387)
Other Administrative expenses		(1,825)	(679)
Total administrative expenses		(2,551)	(1,066)
Other operating income		-	93
Operating loss - continuing operations	2	(2,551)	(973)
Interest receivable		523	52
Loss on ordinary activities before taxation		(2,028)	(921)
Tax on loss on ordinary activities	4	-	-
Loss after taxation for the year	13/14	(2,028)	(921)
Basic and diluted loss per share	5	9 99	6 64

During the period the Group carried out a reorganisation and introduced a new holding company The profit and loss account has been prepared using merger accounting and is presented on a proforma basis as if the new holding company had been in existence throughout both the current and prior periods Further information is given in Note 1

A consolidated profit and loss account from the date of incorporation of the new holding company is given in Note 21

No other gains or losses arose in the year other than those reported above

Additional information on the Consolidated Profit and Loss Account	**2006** £'000	**2005** £'000
Loss on ordinary activities after taxation	(2,028)	(921)
Share option costs	726	387
Adjusted loss after taxation for the year	(1,302)	(534)

Consolidated Balance Sheet

at 31 December 2006

	Note	2006 £'000	2005 £'000
Fixed assets			
Intangible assets	6	41	63
Tangible assets	7	539	47
		580	110
Current assets			
Debtors	9	167	93
Cash at bank and in hand		10,587	12,640
		10,754	12,733
Creditors Amounts falling due within one year	10	(163)	(370)
Net current assets		10,591	12,363
Total assets less current liabilities		11,171	12,473
Creditors Amounts falling due outside one year		-	-
Net assets		11,171	12,473
Capital and reserves			
Called up share capital	12	2,030	2,030
Share premium account	13	9,776	9,776
Other reserve	13	1,335	1,335
Profit and loss reserve	13	(1,970)	(668)
Total Shareholders' funds		11,171	12,473

The financial statements were approved by the Board on 28 February 2007 and signed on its behalf by

John Halfpenny
Director

Company Balance Sheet

at 31 December 2006

	Note	2006 £'000
Fixed assets		
Intangible assets		-
Tangible assets		-
Investments	8	2,473
		2,473
Current assets		
Debtors	9	10,352
Cash at bank and in hand		-
		-
Creditors Amounts falling due within one year	10	-
Net current assets		10,352
Total assets less current liabilities		
Creditors Amounts falling due outside one year		-
Net assets		12,825
Capital and reserves		
Called up share capital	12	2,030
Shares to be issued	13	1,113
Share premium account	13	9,776
Profit and loss reserve	13	(94)
Shareholders' funds		12,825

The financial statements were approved by the Board on 28 February 2007 and signed on its behalf by

John Halfpenny
Director

Consolidated Cash Flow Statement

For the year ended 31 December 2006

	Note	2006 £'000	2005 £'000
Net cash outflow from operating activities	15	(2,000)	(275)
Returns on investments and servicing of finance			
Interest received		523	52
Net cash inflow from returns on investments and servicing of finance		523	52
Capital expenditure			
Purchase of tangible fixed assets	7	(576)	(47)
Net cash outflow for capital expenditure		(576)	(47)
Cash outflow before management of liquid resources and financing		(2,053)	(270)
Management of liquid resources			
Decrease/(increase) in short term deposits		1,775	(12,100)
Net cash inflow/(outflow) from management of liquid resources		1,775	(12,100)
Financing			
Issue of ordinary shares		-	13,834
Share issue expenses		-	(1,082)
Net cash inflow from financing		-	12,752
(Decrease)/increase in cash	16	(278)	382

Notes to the Financial Statements

31 December 2006

1. Accounting Policies

Basis of preparation
During the period the Group carried out a restructuring and introduced a new holding company, CMR Fuel Cells Plc The consolidated Group financial statements incorporate the results of CMR Fuel Cells Plc and its subsidiary undertaking CMR Fuel Cells (UK) Limited as at 31 December 2006 using the merger accounting method

CMR Fuel Cells Plc was incorporated on 12 September 2005 and as such the 2005 and 2006 figures are proforma and represent the results and net assets of CMR Fuel Cells (UK) Limited, adjusted for the shares issued to effect the merger The CMR Fuel Cells Plc consolidated statutory profit and loss account for the period from 12 September 2005 to 31 December 2006 is presented in Note 21 in order to comply with Section 226 of the Companies Act 1985

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

Changes in accounting policies
The Group has adopted FRS 20 'Share based payments' in these financial statements The adoption of this standard represents a change in accounting policy and the comparative figures have been restated accordingly The effect of the prior year adjustment has resulted in an increase in salary costs of £726,000 (2005 £387,000) A credit to reserves offsets this amount

FRS 21 'Post Balance Sheet Events' and FRS 25 'Financial Instruments' apply for the first time to these financial statements but had no impact thereon

Merger accounting
Where merger accounting is used, the investment is recorded in the Company's balance sheet at the nominal value of the shares issued together with the fair value of any additional consideration paid In the Group financial statements, merged subsidiary undertakings are treated as if they had always been a member of the Group The results of such a subsidiary are included for the whole period in the year it joins the Group The corresponding figures for the previous year include its results for that period, the assets and liabilities at the previous balance sheet date and the shares issued by the Company as consideration as if they had always been in issue Any difference between the nominal value of the shares acquired by the Company and those issued by the Company to acquire them is taken to reserves

Intangible fixed assets
Purchased intellectual property is capitalised at the fair value at the date of purchase It is then amortised over five years The carrying value of the asset is reviewed annually for indications of impairment If such indications of impairment are identified, a full impairment review is carried out Any identified impairment is recognised in the profit and loss account

Tangible fixed assets
Tangible fixed assets are included at cost less depreciation Depreciation on tangible fixed assets is calculated so as to write off the cost to their estimated residual value over the estimated useful economic life of the asset Where there is evidence of impairment, tangible fixed assets are reduced to recoverable amount The principal annual rates used are as follows

Plant and machinery (including computer equipment)	25% to 33% straight line
Leasehold improvements	33% straight line
Furniture	25% straight line

Research and development
Research and development expenditure, including patent and intellectual property costs, is written off as incurred

Notes to the Financial Statements

31 December 2006

1. Accounting Policies (continued)

Share based payments
The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted or the effective date of adoption of FRS 20 'Share-based payments' and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award Fair value is determined by using the Black Scholes pricing model In valuing equity-settled transactions, no account is taken of any vesting conditions, other than potential conditions linked to the price of shares of the Company

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance criteria are met

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions and the number of equity instruments that will ultimately vest or in the case of an instrument subject to a market condition, be treated as vesting as described above The movement in cumulative expense since the previous balance sheet date is recognised in the income statement with a corresponding entry in equity

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification No reduction is recognised if this difference is negative

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the income statement

Cash and cash equivalents

Cash and cash equivalents in the balance sheet, comprises cash at bank and short term deposits with an original maturity of less than three months

Investment in subsidiary

Investments in unquoted subsidiaries which do not have a reliable market value are stated at cost less provision for any impairment in value

Pension Contributions
The Company previously operated defined contribution arrangements for the pensions of certain members of staff and certain directors The assets of the schemes were held separately from those of the Company in independently administered funds The amount charged against profits represented the contributions payable to the schemes in the year These arrangements were discontinued after the IPO in December 2005

Foreign Currency Translation
Transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on the dates of transactions Monetary assets and liabilities denominated in such other currencies are retranslated at the rates prevailing on the balance sheet date Profits and losses arising from exchange are included in the income statement for the period

Notes to the Financial Statements

31 December 2006

1. Accounting Policies (continued)

Leases
Assets held under finance leases and hire purchase contracts are included in the balance sheet and depreciated in accordance with the Company's normal accounting policies The present value of future rentals is shown as a liability The interest element of rental obligations is charged to the profit and loss account at a constant rate over the period of the agreement

Rentals applicable to operating leases where substantially all of the benefits and risks of ownership remain with the lessor are charged against profits on a straight line basis over the period of the lease

Government and other grants
Government and other grants are credited to the profit and loss account when the related expenditure is incurred and relevant performance criteria have been achieved Grant income is shown as other operating income

Taxation
Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more tax The principal exception to this is that deferred tax assets are recognised only to the extent that the directors consider that is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date

Liquid resources
Amounts held on short term deposit are included as liquid resources for the purpose of the cash flow statement

2. Operating Loss

Operating loss is arrived at after charging

Group	2006 £'000	2005 £'000
Amortisation of intangible fixed assets	22	22
Depreciation of tangible fixed assets	84	17
Research and development	272	76
Auditors' remuneration		
Fees payable to the Company's auditors for the audit of the financial statements	7	-
Fees payable to the Company's auditors and its associates for other services	-	-
Audit of the financial statements of the Company's subsidiary companies pursuant to legislation	5	5
Other services relating to taxation	-	-
Operating leases		
land and buildings	45	17
plant and machinery	-	8

Notes to the Financial Statements

31 December 2006

3. Employees

Average monthly number of employees, including directors

Group	2006 No	2005 No
Management and administration	5	4
Commercial	-	-
Technical	15	6
	20	10

Staff costs, including directors	2006 £'000	2005 £'000
Wages, salaries and fees	901	319
Social security costs	93	38
Pension costs – defined contribution schemes	-	15
Cost of employee share schemes	726	387
	1,720	759

Detailed information concerning directors' emoluments, shareholdings and share options is shown in the Remuneration Report on pages 16 and 17

Share option costs

During the period, the Company granted for the benefit of directors and employees, the following options under the option schemes noted

Notes to the Financial Statements

31 December 2006

3. Employees (continued)

EMI option scheme

The EMI scheme is intended to allow options to be granted which benefit from favourable tax treatment under the relevant legislation As at 31 December 2006, the Company had issued qualifying EMI options over ordinary shares as follows

At 1 January 2006 Number	Granted in current year Number	Exercised in current year Number	At 31 December 2006 Number	Exercise price per share pence	Fair value price per share pence	Exercise dates
82,110	-	-	82,110	0 626p	125 1p	1/9/05 to 30/8/14
639,660	-	-	639,660	46 09p	126 4p	21/7/06 – 20/7/15(i)
84,000	-	-	84,000	46 09p	126 6p	1/8/06 – 31/7/15(i)
10,360	-	-	10,360	46 09p	126 6p	1/9/06 – 30/8/15 (i)
6,860			6,860	46 09p	126 6p	4/9/06 – 3/9/15 (i)
-	24,500	-	24,500	176p	70 9p	9/1/07 – 8/1/16 (i)
-	6,860	-	6,860	220p	60 1p	1/3/07 – 29/2/16 (i)
-	6,860	-	6,860	215p	62 1p	23/5/07 – 22/5/16 (i)
-	39,000	-	39,000	192 5p	68 2p	14/6/07 – 13/6/16 (ii)
-	6,000	-	6,000	176 5p	72 7p	26/6/07 – 25/6/16 (i)
-	3,000	-	3,000	160 5p	77 9p	31/7/07 – 30/7/16 (i)
-	9,860	-	9,860	155 5p	80 2p	4/9/07 – 3/9/16 (i)
	12,000	-	12,000	155 5p	80 2p	5/9/07 – 4/9/16 (i)
-	6,860	-	6,860	167 5p	76 5p	25/9/07 – 24/9/16 (i)
-	58,650	-	58,650	170 5p	80 3p	2/10/07 – 1/10/16 (i)
822,990	173,590	-	996,580			

Notes to the Financial Statements

31 December 2006

3. Employees (continued)

Unapproved share option scheme

As at 31 December 2006, the Company had issued unapproved share options over ordinary shares as follows

At 1 January 2006 Number	Granted in current year Number	Exercised in current year Number	At 31 December 2006 Number	Exercise price per share pence	Fair value price per share pence	Exercise dates
1,018,570	-	-	1,018,570	46 09	126 4	21/7/06 – 20/7/15 (i)
-	7,350	-	7,350	170 5	70 5	2/10/07 – 1/10/16 (i)
1,018,570	7,350	-	1,025,920			

i) Options vest one third annually commencing on the first anniversary of the date of grant, dependant upon vesting criteria being met Vesting criteria include continued employment within the Company and the achievement of personal milestone targets set for each individual option holder upon grant

ii) Options vest on the same basis as in (i) above save for the fact that they vest one fifth annually

The exercise price was the market value of the shares on the date all of the options were granted

Assumptions used in the valuation of share option costs

In calculating the fair value of the share option costs under the EMI share option and the Unapproved Share Option schemes, the Group has used the Black Scholes model The fair value of the share options under the schemes is shown above and the assumptions used in the calculation of their fair value on the date of grant were as follows

Weighted average value of options -	£1 743
Exercise price -	46 09p – 220 00p
Expected life of option -	3 – 5 vesting period, 3 – 10 year exercise period
Risk-free interest rate -	4 23 – 4 73%
Effects of early exercise -	10% leavers per annum

Expected volatility was determined using the historic volatility of the Company's share price over the expected life of the option

At the date of grant, it was assumed that the non-market performance conditions for all awards would be met Adjustments will be made in future periods, where necessary, to reflect updated assessments of whether the performance conditions will be met The share option expense also takes into account the expected and actual lapses over the vesting period as a result of cessation of employment

It was assumed that no dividend income stream would ensue during the vesting period

A charge of £726,000 (2005 £387,000) has been made in the consolidated profit and loss account to spread the fair value of the share options under the EMI and Unapproved schemes according to the vesting period of the award

Notes to the Financial Statements

31 December 2006

4. Taxation

	2006 £'000	2005 £'000
United Kingdom Corporation tax		
Current tax on income for the year	-	-

Current tax reconciliation	2006 £'000	2005 £'000
Loss on ordinary activities before taxation	(2,028)	(921)
Theoretical tax credit at UK Corporation tax rate of 19% (2005 19%)	(385)	(175)
Effects of		
amounts not deductible for tax purposes	19	7
accelerated capital allowances	-	-
share option tax credit	138	73
trading losses carried forward	228	95
Actual taxation charge	-	-

5. Loss per Share

	2006 £'000	2005 £'000
Basic and diluted loss per share	9 99	6 64
Adjusted loss per share – basic and diluted	6 41	3 85

Adjusted Loss for the year	2006 £'000	2005 £'000
Loss on ordinary activities after taxation	(2,028)	(921)
Share option costs	726	387
Adjusted loss after taxation for the year	(1,302)	(534)

The basic and diluted loss per share are based on the loss for the financial year of £2,028,000 (2005 £921,000) and on ordinary shares of 20,304,846 the weighted average number of shares in issue during the year (2005 13,878,164) The adjusted loss per share is based on an adjusted loss of £1,302,000 (2005 £534,000) As dilution cannot decrease the loss per share, options are non-dilutive

Notes to the Financial Statements

31 December 2006

6. Intangible Fixed Assets

	Intellectual Property £'000
Cost	
At 1 January 2006 and 31 December 2006	111
Amortisation	
At 1 January 2006	48
Charge for year	22
At 31 December 2006	70
Net book value	
At 31 December 2006	41
At 31 December 2005	63

7. Tangible Fixed Assets

	Furniture, fixtures and fittings £'000	Leasehold Improvements £'000	Plant and Machinery £'000	Total £'000
Cost				
At 1 January 2006	-	-	70	70
Additions	124	79	373	576
At 31 December 2006	124	79	443	646
Depreciation				
At 1 January 2006	-	-	23	23
Charge for year	19	13	52	84
At 31 December 2006	19	13	75	107
Net book value				
At 31 December 2006	105	66	368	539
At 31 December 2005	-	-	47	47

Notes to the Financial Statements

31 December 2006

8. Fixed Asset Investments

Company	**Investments in Group undertakings £'000**
Cost and net book value	
Additions	1,360
Shares to be issued	1,113
At 31 December 2006	2,473

The following were subsidiary undertakings at the end of the year and have been included in the consolidated financial statements

Name	Country of incorporation	Proportion of the voting rights and share capital held by the Group and Company	Nature of business
CMR Fuel Cells (UK) Limited	England and Wales	100%	Fuel cell developer

9. Debtors

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000
Other debtors	-	60	-
Prepayments and accrued income	167	33	-
Amounts due from subsidiary company	-	-	10,352
	167	93	10,352

10. Creditors: Amounts falling due within one year

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000
Trade creditors	55	337	-
Other taxation and social security	36	12	-
Accruals and deferred income	72	21	-
	163	370	-

Notes to the Financial Statements

31 December 2006

11. Deferred Taxation

The Company has deferred taxation not recognised, which comprises the following (assets) and liabilities

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000
Accelerated capital allowances	-	-	-
Trading losses	(323)	(95)	-
Share option tax credit	(211)	(73)	-
	(534)	(168)	-

Given that the Company is in its development phase and due to uncertainty surrounding future profits, the directors consider it inappropriate to recognise deferred tax assets in respect of the trading losses

12. Called up Share Capital

	2006 £'000	2005 £'000
Authorised		
34,000,000 ordinary shares of 10p each	3,400	3,400
Allotted issued and fully paid		
20,304,846 ordinary shares of 10p each	2,030	2,030

On 13 September 2005, the Company was incorporated with authorised share capital of 20,799,400 ordinary shares of 10p each, 6,845,900 A ordinary shares of 10p each and 6,354,700 B ordinary shares of 10p each On this date Michael Priestnall subscribed at par for 1 ordinary 10p share

On 30 September 2005, the Company issued 4,359,879 ordinary 10p shares, 4,792,130 A ordinary shares and 4,448,290 B ordinary shares in exchange for the entire issued share capital of CMR Fuel Cells (UK) Limited

On 13 December 2005, the Company simplified its capital structure, converting authorised and issued A and B ordinary shares into ordinary shares

On 13 December 2005, 852,273 ordinary shares in the Company were issued to CF Group Holdings Limited, a company of which Gordon Crawford is the sole shareholder, for an aggregate consideration of £1 2 million equivalent to a price per share of £1 408

On 16 December 2005, 5,852,273 ordinary shares were issued at £1 76 each as part of the placing and admission to AIM

Details of share options granted over shares in the Company are given in note 3

Notes to the Financial Statements

31 December 2006

13. Reserves

Group	Issued Share capital £'000	Share premium account £'000	Other reserve £'000	Profit and loss account £'000	Total £'000
At 1 January 2006	2,030	9,776	1,335	(668)	12,473
Loss for the year	-	-	-	(2,028)	(2,028)
Share option costs	-	-	-	726	726
At 31 December 2006	2,030	9,776	1,335	(1,970)	11,171

The other reserve was created upon the merger of CMR Fuel Cells (UK) Limited and CMR Fuel Cell Plc

Company	Issued share capital £'000	Share premium account £'000	Profit and Loss Account £'000	Shares to be issued £'000	Total £'000
At 15 September 2005 (date of incorporation)	-	-	-	-	-
Shares issued in December 2005	2,030	10,830	-	-	12,860
Share issue expenses	-	(1,054)		-	(1,054)
Loss for the period	-	-	(94)	-	(94)
Share option costs	-	-	-	1,113	1,113
At 31 December 2006	2,030	9,776	(94)	1,113	12,825

Notes to the Financial Statements

31 December 2006

14. Reconciliation of Movement in Shareholders' Funds

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000
Loss for the period	(2,028)	(921)	(94)
Adjustment in respect of employee share schemes	726	387	1,113
Shares issued in December 2005	-	-	12,860
Share issue expenses	-	-	(1,054)
Net decrease in shareholders' funds	(1,302)	(534)	12,825
Opening shareholders' funds	12,473	13,007	-
Closing shareholders' funds	11,171	12,473	12,825

15. Reconciliation of Operating Loss to Net Cash Outflow from Operating Activities

Group	2006 £'000	2005 £'000
Operating loss	(2,551)	(973)
Amortisation of intangible fixed assets	22	17
Depreciation of tangible fixed assets	84	22
Increase in debtors	(74)	(86)
(Decrease)/increase in creditors	(207)	358
Other non cash changes	726	387
Net cash outflow from operating activities	(2,000)	(275)

16. Reconciliation of Net Cash Flow to Movement in Net Funds

	2006 £'000	2005 £'000
(Decrease)/increase in cash	(278)	382
(Decrease)/increase in liquid resources	(1,775)	12,100
(Decrease)/increase in net funds from cash flows and for the period	(2,053)	12,482
Opening net funds	12,640	158
Closing net funds	10,587	12,640

Notes to the Financial Statements

31 December 2006

17. Analysis of Net Funds

	1 January 2006 £'000	Cash flow £'000	31 December 2006 £'000
Cash at bank and in hand	540	(278)	262
Short term deposits	12,100	(1,775)	10,325
Net funds	12,640	(2,053)	10,587

18. Financial Commitments

Operating lease commitments

The payments which the Group is committed to make in the next year under operating leases are as follows

	2006 £'000	2005 £'000
Land and buildings, leases expiring		
Within one year	57	12
Between two and five years	97	-

19. Related Party Transactions

Sagentia Limited (formerly Scientific Generics Limited)

Sagentia Limited is a related party by virtue of its minority shareholding in the Company

During the year ended 31 December 2006 the Company made purchases from Sagentia Limited in respect of rental and service costs relating to occupancy of premises in Harston Mill totalling £119,000 (2005 £22,000), which are included in administrative expenses At 31 December 2006 the amount owing to Sagentia Limited was £377 (2005 £11,000)

Manage5Nines Limited

Manage5Nines Limited is a wholly owned subsidiary of Sagentia Group Limited (formerly Generics Group Limited) Sagentia Limited is also a wholly owned subsidiary of Sagentia Group Limited and so by virtue of this Manage5Nines Limited is also a related party

During the year ended 31 December 2006 £41,000 (2005 £9,000) of costs relating to the provision of IT support services were incurred and are included in administrative expenses The balance owed by the Company at 31 December 2006 was £8,107 (2005 £2,000)

Notes to the Financial Statements

31 December 2006

20. Financial Instruments

Interest Rate and currency of cash balances

Floating rate financial assets (excluding short term debtors and creditors) comprise -

Group	As at 31 December 2006 £'000	As at 31 December 2005 £'000
Sterling	10,585	12,640
US Dollar	2	-
	10,587	12,640

The fair value floating rate financial assets is not materially different from their book value

Treasury policy

The Group's operations are financed by the cash raised by the Group in the placing of shares in December 2005

Conscious of the fact that Group is still in its development phase, the Group's policy towards using financial instruments is to manage credit, interest rate and liquidity risk without exposing the Group to undue risk or speculation The policy is kept under review by the directors according to the Group's treasury policy

All financial instruments are held in cash or short term deposits The Group monitors its exposure to credit risk on an ongoing basis Cash investments are only allowed in liquid securities with major financial institutions that satisfy specific criteria The maximum credit risk exposure at the balance sheet date is represented by the carrying value of financial assets and there are no significant concentrations of credit risk

The weighted average interest rate earned over the year on the financial instruments was 4 5% By comparison, the average Bank of England Base rate over the same period was 4,6%

Notes to the Financial Statements

31 December 2006

21. Statutory Profit and Loss Account

The profit and loss account below is required by the Companies Act 1985 and covers the first statutory accounting period of CMR Fuel Cells Plc from its date of incorporation on 12 September 2005 to 31 December 2006 Disclosure notes for this period are not presented as the directors believe they would not provide meaningful information to users of the accounts Any directors' remuneration for the period is included within the amounts disclosed in the Remuneration Report on page 16

	Period from 12 September 2005 to 31 December 2006 £'000
Turnover	-
Other Administrative expenses	94
Share option expenses	-
Total administrative expenses	94
Other operating income	-
Operating loss - continuing operations	94
Interest receivable	-
Loss on ordinary activities before taxation	94
Tax on loss on ordinary activities	-
Loss after taxation for the period	94