

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

Report and Consolidated Financial Statements

31 December 2008

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KERONITE GROUP LIMITED
(formerly KERONITE PLC)

REPORT AND FINANCIAL STATEMENTS 31 DECEMBER 2008

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KERONITE GROUP LIMITED

(formerly KERONITE PLC)

DIRECTORS' REPORT

The directors present their annual report and the audited consolidated financial statements for the year ended 31 December 2008.

This report has been prepared in accordance with the special provisions relating to small companies under Section 246 (4) of the Companies Act 1985.

CHANGE OF STATUS AND NAME

The Company re-registered as a private limited company on 17 December 2008 and changed its name to Keronite Group Limited.

PRINCIPAL ACTIVITY

The principal activity of the Group is the commercialisation of the Keronite process. This is a proprietary surface treatment technology which uses plasma electrolytic oxidation (PEO) to convert the surface of light alloys such as aluminium and magnesium into a hard, dense ceramic, resistant to both corrosion and wear. The principal activity of Keronite Group Limited (formerly Keronite plc) is that of a holding company.

REVIEW OF DEVELOPMENTS AND FUTURE PROSPECTS

The directors expect the Company to continue trading for the foreseeable future, and are satisfied with the completion of the Company's recent fundraising will (see note 1). Keronite International Limited is a wholly owned subsidiary of Keronite Group Limited and is the main UK trading entity. This entity is forecast to increase sales as the markets improve.

GOING CONCERN

The directors have considered the going concern basis of preparation of the financial statements. The current economic environment has created uncertainties over the level of future revenue and realisation of the Group's sales leads, however the Board has specifically considered the level of forecast sales, as part of the cash flow forecast and developed a streamlined cost base which has already resulted in a slowdown of the Group's cash burn, and is satisfied that the Group and Company can meet liabilities as they fall due for the foreseeable future, being a period of not less than 12 months from the date of approval of these financial statements.

The Keronite Group successfully raised £670k (gross of expenses) in October 2009, (see note 22). The cash from this fundraising combined with the successful conversion of the anticipated order book for the twelve months from the date of signing these accounts form the basis of the Board's adoption of the going concern basis of preparation. Additionally, there have been significant changes in the business over the year, which has seen a move to grow service based sales, and reducing reliance on more cyclical equipment sales.

Refer to note 1 for full discussion of the adoption of the going concern basis of preparation.

KEY PERFORMANCE INDICATORS (KPI's)

The Group and Company continues to monitor key performance indicators in all areas of the business which are linked to the strategy of the business and which can be implemented, measured and monitored on a regular basis.

The following KPI's are monitored by the Group

	2008	2007
Turnover growth over prior year	22%	(42%)
Gross margin	52%	52%
Number of new leases/licences	3	2
(Decrease)/Increase in customer enquiries	(34%)	39%
Cash used in operating activities	(£1.8m)	(£2.6m)
Year end cash balance	£1.6m	£0.3m
Growth in service revenue	80%	(21%)

Other non financial KPI's include the monitoring of marketing statistics, manufacturing lead times, efficiency of Research and Development expenditures and the recovery of Research and Development costs.

KERONITE GROUP LIMITED
(formerly KERONITE PLC)
DIRECTORS' REPORT (continued)

POST BALANCE SHEET EVENTS

During October 2009, Keronite Group Limited raised funds of £670k (gross of expenses) through the issue of redeemable loan notes to existing shareholders. The funds were received during October 2009.

RESULTS AND DIVIDENDS

The loss on ordinary activities before taxation was £2.8m (2007 - £3.8m). The directors do not recommend the payment of a dividend (2007 - £nil).

DIRECTORS

The directors who served during the year and to the date of this report were:

Lars Olrik	(resigned 12 September 2008)
Peter Denyer	(resigned 1 November 2008)
Steven Hutchins	
Alexander Smart	
Amanda Thorneycroft	(resigned 31 January 2009)
Charles Halle	(appointed 21 April 2008)
Steve Murphy	(appointed 3 November 2008)
Nick Habgood	

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally 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 the Group and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed; 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 proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INTERNAL CONTROL AND RISK MANAGEMENT

The Board is responsible for ensuring that the Group maintains a system of internal financial controls, including suitable monitoring procedures. The object of the system is to safeguard Group assets, ensure proper accounting records are maintained and that the financial information produced by the Group is reliable.

Internal financial control monitoring procedures undertaken by the Board of directors include the approval of the annual budgets and forecasts, review of monthly financial reports and monitoring of performance, and the prior approval of all significant expenditure.

FOREIGN EXCHANGE RISK MANAGEMENT

The Group has transactions denominated in foreign currencies. In particular, this relates to transactions with US based clients and Keronite International Limited's subsidiaries.

No financial instrument is used to protect the Group against foreign currency risk.

KERONITE GROUP LIMITED
(formerly KERONITE PLC)
DIRECTORS' REPORT (continued)

CREDIT RISK MANAGEMENT

The Group's principal financial assets are bank balances and trade debtors including monies due under equipment/licence supply contracts. The Group's credit risk is primarily attributable to its debtors. The amounts presented in the balance sheet are net of provisions for doubtful debts. The Group has a number of customers and as such has spread the credit risk over a number of parties. The credit risk on liquid funds is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

SUPPLIER PAYMENT POLICY

The Group's policy is to settle terms of payment with suppliers in line with those suppliers' standard terms and conditions. At the year end trade creditor days were 60 days (2007 - 41 days).

DIRECTORS' INDEMNITIES

The Group made qualifying third party indemnity provisions for the benefit of its directors which remain in force at the date of this report.

AUDITORS

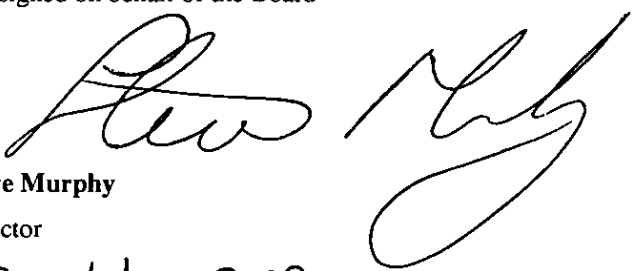
In the case of each of the persons who are directors of the Company at the date when this report was approved:

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

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

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

Approved by the Board of Directors
and signed on behalf of the Board


Steve Murphy
Director

23 October 2009

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KERONITE GROUP LIMITED (formerly KERONITE PLC)

We have audited the Group and parent Company financial statements (the "financial statements") of Keronite Group Limited (formerly Keronite plc) for the year ended 31 December 2008 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and parent Company balance sheets, the consolidated cash flow statement and the related notes 1 to 23. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

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

Our responsibility is to audit the financial statements in accordance with relevant 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 are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Chairman's statement that is cross-referenced from the Review of Developments and Future prospects section of the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors statement and the Chairman's 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 further information outside the financial statements.

Basis of audit opinion

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

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KERONITE GROUP LIMITED (formerly KERONITE PLC) (continued)

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent Company's affairs as at 31 December 2008 and of the Group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Emphasis of matter

Without qualifying our opinion, we draw attention to the disclosures made in note 1 concerning the Group's ability to continue as a going concern. The Group incurred a net loss of £2.7m during the year ended 31 December 2008, and has continued to incur losses post year end.

The directors have prepared a cash flow forecast which makes assumptions about the conversion of forecast sales leads, and the subsequent receipt of cash relating to those forecast sales. The ability of the Group to continue as a going concern is dependent on the Group achieving the level of sales anticipated in the forecast.

This, along with other matters set forth in note 1, indicate the existence of a material uncertainty which may cast significant doubt over the Group's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Group was unable to continue as a going concern as it is not practicable to determine or quantify them.

Deloitte LLP

Deloitte LLP
Chartered Accountants and Registered Auditors
Cambridge, United Kingdom

23 October 2009

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

CONSOLIDATED PROFIT AND LOSS ACCOUNT
Year ended 31 December 2008

	Note	2008 £	2007 £
TURNOVER	2	1,961,058	1,611,843
Cost of sales		(943,997)	(771,751)
GROSS PROFIT		<u>1,017,061</u>	<u>840,092</u>
Administrative expenses		(3,233,341)	(4,698,592)
OPERATING LOSS	3	(2,216,280)	(3,858,500)
Finance (charges) income (net)	5	(628,741)	88,934
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION		<u>(2,845,021)</u>	<u>(3,769,566)</u>
Tax on loss on ordinary activities	6	155,861	141,994
LOSS FOR THE FINANCIAL YEAR	17	<u>(2,689,160)</u>	<u>(3,627,572)</u>

All activities derive from continuing operations.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
Year ended 31 December 2008

	2008 £	2007 £
Loss for the financial year	(2,689,160)	(3,627,572)
Currency translation difference on foreign currency subsidiaries	144,159	-
Total recognised gains and losses	<u>(2,545,001)</u>	<u>(3,627,572)</u>

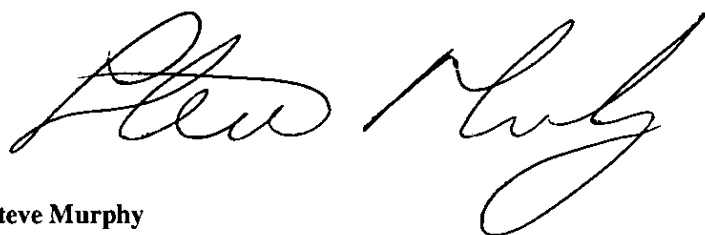
KERONITE GROUP LIMITED
(formerly KERONITE PLC)

CONSOLIDATED BALANCE SHEET
31 December 2008

	Note	2008 £	2007 £
FIXED ASSETS			
Intangible assets	8	337,544	374,601
Tangible assets	9	539,032	867,701
		<u>876,576</u>	<u>1,242,302</u>
CURRENT ASSETS			
Stocks	11	534,988	620,431
Debtors			
Amounts falling due within one year	12	766,413	995,543
Amounts falling due after more than one year	12	876,648	627,078
Current asset investments - short term deposits		1,000,000	-
Cash at bank and in hand		607,541	334,352
		<u>3,785,590</u>	<u>2,577,404</u>
CREDITORS: amounts falling due within one year	13	(837,595)	(1,268,047)
NET CURRENT ASSETS		<u>2,947,995</u>	<u>1,309,357</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		3,824,571	2,551,659
PROVISION FOR LIABILITIES	14	(215,641)	(188,600)
NET ASSETS		<u>3,608,930</u>	<u>2,363,059</u>
CAPITAL AND RESERVES			
Called up share capital	15,17	5,995,685	2,116,680
Share premium account	17	7,073,735	7,244,356
Merger reserve	17	6,380,703	6,380,703
Profit and loss account	17	(15,841,193)	(13,378,680)
SHAREHOLDERS' FUNDS	17	<u>3,608,930</u>	<u>2,363,059</u>

The financial statements of Keronite Group Limited, registered number 5564452, were approved by the Board of Directors and authorised for issue on **23 October 2009**.

Signed on behalf of the Board of Directors



Steve Murphy
Director

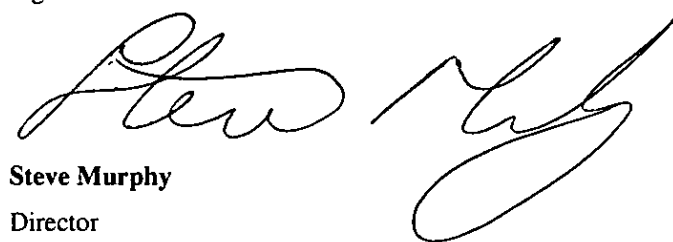
KERONITE GROUP LIMITED
(formerly KERONITE PLC)

BALANCE SHEET
31 December 2008

	Note	2008 £	2007 £
FIXED ASSETS			
Investments	10	<u>481,062</u>	<u>481,062</u>
CURRENT ASSETS			
Debtors	12	11,244,491	8,483,442
CREDITORS: amounts falling due within one year	13	<u>(8,165)</u>	<u>(58,946)</u>
NET CURRENT ASSETS		<u>11,236,326</u>	<u>8,424,496</u>
TOTAL ASSETS LESS CURRENT LIABILITIES, BEING NET ASSETS		<u>11,717,388</u>	<u>8,905,558</u>
CAPITAL AND RESERVES			
Called up share capital	15,17	5,995,685	2,116,680
Share premium account	17	7,073,735	7,244,356
Profit and loss account	17	<u>(1,352,032)</u>	<u>(455,478)</u>
SHAREHOLDERS' FUNDS	17	<u>11,717,388</u>	<u>8,905,558</u>

The financial statements of Keronite Group Limited, registered number 5564452, were approved by the Board of Directors and authorised for issue on

Signed on behalf of the Board of Directors


Steve Murphy
Director

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

CONSOLIDATED CASH FLOW STATEMENT
Year ended 31 December 2008

	Note	2008 £	2007 £
Net cash outflow from operating activities	19	<u>(1,845,311)</u>	<u>(2,589,926)</u>
Returns on investments and servicing of finance			
Interest received		18,037	89,832
Interest paid		<u>(3,132)</u>	<u>-</u>
Net cash inflow from returns on investments and servicing of finance		<u>14,905</u>	<u>89,832</u>
Taxation			
R&D tax credit received		<u>144,669</u>	<u>-</u>
Net cash outflow from taxation		<u>144,669</u>	<u>-</u>
Capital expenditure and financial investment			
Purchase of tangible fixed assets		<u>(36,207)</u>	<u>(415,502)</u>
Net cash inflow from capital expenditure, taxation and financial investment		<u>(36,207)</u>	<u>(415,502)</u>
Net cash outflow before financing and management of liquid resources		<u>(1,721,944)</u>	<u>(2,915,596)</u>
Financing			
Issue of ordinary share capital at a premium		-	124,027
Issue of preference shares		1,766,198	-
Issue of new debt		<u>1,228,935</u>	<u>-</u>
Net cash inflow from financing		<u>2,995,133</u>	<u>124,027</u>
Management of liquid resources			
Increase in short term deposits		<u>(1,000,000)</u>	<u>-</u>
Net cash outflow from management of liquid resources		<u>(1,000,000)</u>	<u>-</u>
Increase/(decrease) in cash in the year	20/21	<u>273,189</u>	<u>(2,791,569)</u>

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2008

1. ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable United Kingdom accounting standards. The particular accounting policies adopted are described below. They have all been applied consistently throughout the current and preceding year.

The address of the Company's Registered Office is Granta Park, Great Abington, Cambridge CB21 6GP.

Basis of accounting

The financial statements are prepared under the historical cost convention.

The directors have considered the going concern basis of preparation of the financial statements. As with many businesses, the current economic environment has created uncertainties over the level of future revenue and realisation of the Group's sales leads. However the Board has specifically considered the level of forecast sales, as part of the cash flow forecast and developed a reduced cost base which has already resulted in a slowdown of the Group's cash burn. The Board is satisfied that the Group and Company can meet liabilities as they fall due for the foreseeable future, being a period of not less than 12 months from the date of approval of these financial statements.

The Keronite Group successfully raised £670k (gross of expenses) in October 2009, (see note 22). The cash from this fundraising combined with the successful conversion of the anticipated order book for the twelve months from the date of signing these accounts form the basis of the Board's adoption of the going concern basis of preparation. Additionally, there have been significant changes in the business over the year, which has seen a move to grow service based sales, and reducing reliance on more cyclical equipment sales.

The conversion of forecast sales to cash in line with the cash flow forecast represents the existence of a material uncertainty which may cast significant doubt over the Group's ability to continue as a going concern. However, given the successful fundraising, the directors believe that they have a reasonable expectation that the Group will be able to continue as a going concern for the foreseeable future. These financial statements therefore do not include the adjustments that would result if the Group were unable to continue as a going concern as it would not be practicable to determine or quantify them.

Basis of consolidation

The Group financial statements consolidate the financial statements of Keronite Group Limited (formerly Keronite plc) and its subsidiaries drawn up to 31 December each year. Acquisitions are accounted for under the acquisition method. Turnover and profits arising on trading between Group companies are excluded.

Turnover

Turnover represents the amount receivable for licence/lease sales, sales of consumables, royalties and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes.

Licence/lease agreements grant the licence of the Keronite technology to customers along with the provision of equipment in order for them to carry out the Keronite process. Revenue arising on licence/lease sales is recognised in its entirety on the inception of the agreement. Finance charges relating to outstanding amounts under these agreements are taken to profit and loss account on a reducing balance basis.

Sales of consumables relate predominantly to sales of electrolyte, used in the Keronite process.

Intangible assets - goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight-line basis over its useful economic life, which is considered to be 15 years. Provision is made for any impairment.

Intangible assets - intellectual property

Intellectual property is included at cost and amortised in equal annual instalments over a period of 15 years which is its estimated useful economic life. Provision is made for any impairment.

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2008

1. ACCOUNTING POLICIES (continued)

Research and development

Research and development expenditure is written off as incurred.

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation on fixed assets is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight line basis over its expected useful life, as follows:

Furniture and fittings	3 years
Plant and machinery	5 years
Computer equipment	3 years

Investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

Stocks

Stocks, work-in-progress and finished goods are stated at the lower of cost and net realisable value. Cost represents materials, direct labour and overheads attributable to the stage of production.

Foreign exchange

Transactions denominated in foreign currencies are translated into sterling at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates ruling at that date. Translation differences arising are dealt with in the profit and loss account.

The results of overseas operations are translated at the closing rates of exchange during the period and their balance sheets at the rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets are reported in the statement of total recognised gains and losses. All other exchange differences are included in the profit and loss account.

Finance costs

Finance costs are recognised in the profit and loss account over the term of the related debt instrument at a constant rate on the carrying amount.

Taxation

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

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

Leases

Operating lease rentals are charged to the profit and loss account in equal annual amounts over the lease term.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other short term, liquid investments readily convertible to cash and subject to an insignificant risk of changes in value.

KERONITE GROUP LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2008

1. ACCOUNTING POLICIES (continued)

Pension costs

The Group operates a stakeholder pension scheme. It also makes contributions to personal pension schemes operated by the individual employees either directly or through their salary, at the discretion of each employee. All contributions are charged to the profit and loss account in the period to which they relate.

Share-based payments

The Group issued equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest.

Fair value is measured using the Black Scholes Model. The expected life in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

2. TURNOVER

	2008	2007
	£	£
By geographical market:		
United Kingdom	213,608	294,148
Rest of Europe	681,732	362,451
Rest of World	1,065,718	955,244
	<u>1,961,058</u>	<u>1,611,843</u>

The Group only has one class of business which is described in the directors' report.

An analysis of net assets and loss before tax by class of business and geographical location is not presented, as, in the opinion of the directors, such disclosure would be prejudicial to the interests of the Group.

3. OPERATING LOSS

	2008	2007
	£	£
Operating loss is after charging (crediting):		
Exceptional item - Redundancy costs	64,000	-
Exceptional item - Bad debts arising from previous years' sales	-	512,248
Depreciation of owned tangible fixed assets	292,187	282,910
Impairment of tangible fixed asset	-	46,875
Amortisation of intangible fixed assets	37,057	37,150
Rentals under operating leases - Land and buildings	170,674	106,112
- Other	9,285	9,940
Finance lease revenue received	(1,236,355)	(1,060,418)
Research and development expenditure	650,554	622,931
Auditors' remuneration payable to Deloitte LLP		
- Company	4,000	6,000
- Group	25,000	31,074
Auditors' remuneration payable to Alerding & Co	-	8,306
Other fees paid to Deloitte LLP		
- Tax compliance services	15,250	32,500
- Tax advisory services	25,350	25,094
	<u>15,250</u>	<u>32,500</u>
	<u>25,350</u>	<u>25,094</u>

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2008

4. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

	2008 £	2007 £
Directors' remuneration		
Emoluments	479,064	383,517
Compensation for loss of office	61,886	47,500
	<hr/>	<hr/>
Total Emoluments	540,950	431,017
Company contributions to money purchase pension schemes	7,600	7,832
	<hr/>	<hr/>
	548,550	438,849
	<hr/>	<hr/>
Highest paid director's remuneration		
Emoluments	90,536	123,442
Compensation for loss of office	64,004	-
Company contribution to money purchase pension scheme	7,600	-
	<hr/>	<hr/>
	162,140	123,442
	<hr/>	<hr/>
	No	No
Average number of persons employed by the Group during the year was:		
Sales and marketing	6	8
Research and development	11	6
Production	7	6
Administration	8	11
	<hr/>	<hr/>
	32	31
	<hr/>	<hr/>
	£	£
Staff costs during the year (including directors)		
Wages and salaries	1,455,155	1,534,318
Social security costs	241,425	173,132
Pension costs	9,646	14,623
	<hr/>	<hr/>
	1,706,226	1,722,073
	<hr/>	<hr/>

Other than directors the Company has no employees and incurred no staff costs in either financial year.

5. FINANCE (CHARGES) INCOME (NET)

	2008 £	2007 £
Bank interest receivable	18,037	88,934
Bank interest paid	(3,132)	-
Interest paid on shareholder loans	(269,130)	-
Premiums paid on bridging loan	(374,516)	-
	<hr/>	<hr/>
	(628,741)	88,934
	<hr/>	<hr/>

KERONITE GROUP LIMITED
(formerly KERONITE PLC)

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2008

6. TAX ON LOSS ON ORDINARY ACTIVITIES

	2008 £	2007 £
Corporation tax		
Tax credit on research and development expenditure	(155,861)	(141,994)
Circumstances affecting the current tax charge:		
The standard rate of current tax for the year, based on the UK standard rate of corporation tax is 28% (2007 - 30%). The current tax charge for the year was less than 28% (2007 - 30%) for the reasons set out in the following reconciliation.		
	2008 £	2007 £
Loss on ordinary activities before taxation	(2,845,021)	(3,769,566)
Tax at 28% (2007 - 30%) thereon	(796,606)	(1,130,870)
Expenses not deductible for tax purposes	73,427	43,018
Capital allowances in deficit of depreciation	34,037	16,429
Current year losses not recognised as a deferred tax asset	503,754	1,011,132
Movement in short term timing differences	8,190	12,180
Additional deduction for qualifying research and development	(106,825)	(32,236)
Surrender of tax losses for research and development tax credit	284,022	80,347
Adjustment to tax charge in respect of previous periods	(2,675)	-
Research and development tax credit	(153,185)	(141,994)
Current tax credit	(155,861)	(141,994)

In March 2007 the UK government announced that they would introduce legislation that would reduce the corporation tax rate to 28% with effect from 1 April 2008. The legislation was substantially enacted in June 2007. The effective tax rate for any current tax charge for the year ended 31 December 2008 has reduced accordingly.

7. LOSS OF PARENT COMPANY

The loss for the year made by Keronite Group Limited (formerly Keronite plc) was £944,013 (2007 - £231,018). As permitted by section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent Company.

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8. INTANGIBLE FIXED ASSETS

GROUP	Goodwill £	Intellectual property £	Total £
Cost			
At 1 January 2008 and 31 December 2008	337,215	220,038	557,253
Amortisation			
At 1 January 2008	149,077	33,575	182,652
Charge for the year	22,388	14,669	37,057
At 31 December 2008	171,465	48,244	219,709
Net book value			
At 31 December 2008	165,750	171,794	337,544
At 31 December 2007	188,138	186,463	374,601

There are no intangible assets belonging to the Company at either balance sheet date.

9. TANGIBLE FIXED ASSETS

GROUP	Furniture and fittings £	Plant and machinery £	Computer equipment £	Total £
Cost				
At 1 January 2008	241,310	1,436,178	197,564	1,875,052
Additions	17,071	17,424	1,712	36,207
Transfers	-	(187,125)	-	(187,125)
Disposals	-	(17,169)	-	(17,169)
Foreign exchange gains	33,096	40,218	6,103	79,417
At 31 December 2008	291,477	1,289,526	205,379	1,786,382
Depreciation				
At 1 January 2008	104,674	802,079	100,598	1,007,351
Charge for the year	74,799	168,163	49,225	292,187
Transfers	-	(46,875)	-	(46,875)
Disposals	-	(15,442)	-	(15,442)
Foreign exchange gains	3,949	5,187	993	10,129
At 31 December 2008	183,422	913,112	150,816	1,247,350
Net book value				
At 31 December 2008	108,055	376,414	54,563	539,032
At 31 December 2007	136,636	634,099	96,966	867,701

There are no tangible assets belonging to the Company at either balance sheet date.

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10. INVESTMENTS HELD AS FIXED ASSETS

COMPANY

At 31 December 2008 the Company held the following investments:

100% interest in the ordinary share capital of Keronite International Limited, a Company incorporated in England and Wales whose principal activity is the commercialisation of the Keronite process.

The Company also held the following investments through its 100% owned subsidiary Company, Keronite International Limited:

100% interest in the ordinary share capital of Isle Coat Limited, a Company incorporated in the Isle of Man, whose principal activity is surface engineering.

100% interest in the ordinary share capital of ICS Systems Limited, a Company incorporated in England and Wales. ICS Systems Limited did not trade in the year.

100% interest in the ordinary share capital of Keronite Inc a Company incorporated in the United States of America. The principal activity of the Company is the commercialisation of the Keronite process in the United States of America.

100% interest in the ordinary share capital of Keronite Surface Coating (Chongqing) Limited a Company incorporated in China. The principal activity of the Company is surface engineering.

**Shares in subsidiary
undertakings
£**

Cost and net book value

As at 1 January 2008 and 31 December 2008

481,062

11. STOCKS

GROUP

**2008
£**

**2007
£**

Finished goods and goods for resale

534,988

620,431

In the opinion of the directors, there is no material difference between the balance sheet value of stocks and their replacement cost.

At the year end the Company held no stock (2007 - £nil).

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12. DEBTORS

	GROUP		COMPANY	
	2008	2007	2008	2007
	£	£	£	£
Amounts falling due within one year:				
Trade debtors	368,487	463,545	-	-
Lease receivables	120,000	259,165	-	-
Research and Development tax claim debtor	153,186	141,994	-	-
VAT	6,672	7,535	-	-
Other debtors	26,309	28,203	-	-
Amounts owed by Group undertakings	-	-	11,244,491	8,483,442
Prepayments and accrued income	91,759	95,101	-	-
	<u>766,413</u>	<u>995,543</u>	<u>11,244,491</u>	<u>8,483,442</u>
Amounts falling due after more than one year:				
Lease receivables	<u>876,648</u>	<u>627,078</u>	<u>-</u>	<u>-</u>

13. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	GROUP		COMPANY	
	2008	2007	2008	2007
	£	£	£	£
Trade creditors	406,042	421,807	-	-
Taxation and social security	41,264	53,277	-	-
Other creditors	128,177	149,038	184	-
Accruals and deferred income	262,112	643,925	7,981	58,946
	<u>837,595</u>	<u>1,268,047</u>	<u>8,165</u>	<u>58,946</u>

14. PROVISION FOR LIABILITIES

Provision in respect of product warranties

	GROUP
	£
At 1 January 2008	188,600
Charged to the profit and loss account	<u>27,041</u>
At 31 December 2008	<u>215,641</u>

The provision for product warranties relates to expected warranty claims on products sold in the last three years. It is expected that this expenditure will be incurred over the remaining warranty period and the timing of this expenditure is uncertain.

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14. PROVISIONS FOR LIABILITIES (continued)

Deferred taxation

GROUP

The deferred tax asset provided in the accounts and the amounts not provided are as follows:

	Provided		Not provided	
	2008	2007	2008	2007
	£	£	£	£
Accelerated capital allowances	-	-	27,592	-
Other timing differences	-	-	60,368	-
Losses	-	-	3,092,855	3,426,496
	<u>-</u>	<u>-</u>	<u>3,180,815</u>	<u>3,426,496</u>

A deferred asset has not been recognised in respect of timing differences relating to tax losses carried forward as there is insufficient evidence that the asset will be recovered in the foreseeable future. The amount of the asset not recognised is £3,180,815 (2007 - £3,426,496). The asset would be recovered if there were suitable taxable profits in subsequent accounting periods of the appropriate Group undertakings.

15. CALLED UP SHARE CAPITAL

	Number	Value
		£
Authorised share capital		
At 1 January 2008 shares of 1p each	586,151,000	5,862,510
At 31 December 2008 shares of 1p each	770,000,000	7,700,000
	<u>1,356,151,000</u>	<u>13,562,510</u>
Called up, allotted and fully paid		
At 1 January 2008 ordinary shares of 1p each	211,668,049	2,116,680
A Preferred Shares issued	365,898,035	3,658,980
AA Preferred Shares issued	22,002,445	220,025
	<u>599,568,529</u>	<u>5,995,685</u>
At 31 December 2008 shares of 1p each		

On 11 November 2008, the Company issued 230,898,035 A Preferred Shares at 1 pence each and 22,002,445 AA Preferred shares at 1 pence each. On 27 November 2008, the Company issued a further 135,000,000 A Preferred shares at 1 pence each. These shares were issued to settle the conversion rights of the new loan issued to the Group in February 2008 of £1,228,935 plus the related interest and premiums totalling £643,646. The Group received cash for the remaining shares of £1,766,198 which was received net of expenses of £240,226 deducted at source.

In the event of a winding up or liquidation, the assets of the Company available for distribution after payment of liabilities will be distributed first to the A preferred shareholders to 2 times the issue price of the A preferred shares, and then to the AA preferred shareholders and the ordinary shareholders, pro rata to the respective nominal values of those shares.

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16. SHARE BASED PAYMENTS

Equity-settled share option scheme

Keronite Group Limited (formerly Keronite plc) has a share option scheme for all employees. The fair value of the share options granted is calculated by use of the Black Scholes model. Options are exercisable at a price equal to the market price at date of grant. The vesting period is on IPO for certain options and over 3 years for other options. If the options remain unexercised after a period of ten years from the date of grant the options expire. Options are forfeited if the employee leaves the Group before the options vest.

Details of the share options outstanding during the year are as follows:

	Number of share options	2008 Weighted average exercise price	Number of share options	2007 Weighted average exercise price
Outstanding at beginning of year	25,204,066	6p	27,129,066	6p
Forfeited during the year	(1,790,600)	6p	(1,925,000)	6p
Outstanding at the end of the year	<u>23,413,466</u>	6p	<u>25,204,066</u>	6p
Exercisable at the end of the year	<u>4,898,100</u>	6p	<u>-</u>	-

There were no options issued in 2008. The aggregate estimated fair value of the options issued in 2006 is £454,000. The options have a remaining weighted average contractual life of 7 years (2007 - 8 years).

Expected volatility was determined using the historical volatility of the share prices of AIM listed companies in similar businesses to Keronite over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

The Group recognised total expenses of £82,488 and £143,395 related to equity-settled share-based payment transactions in 2008 and 2007 respectively.

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17. STATEMENT OF MOVEMENT IN RESERVES AND RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Called up share capital £	Profit and loss account £	Share premium account £	Merger reserve £	2008 Total £	2007 Total £
GROUP						
At 1 January 2008	2,116,680	(13,378,680)	7,244,356	6,380,703	2,363,059	5,723,209
Issue of shares	3,879,005	-	-	-	3,879,005	124,027
Issue costs	-	-	(170,621)	-	(170,621)	-
Loss for the financial year	-	(2,689,160)	-	-	(2,689,160)	(3,627,572)
Currency translation difference	-	144,159	-	-	144,159	-
Credit to reserves for share based payments	-	82,488	-	-	82,488	143,395
At 31 December 2008	<u>5,995,685</u>	<u>(15,841,193)</u>	<u>7,073,735</u>	<u>6,380,703</u>	<u>3,608,930</u>	<u>2,363,059</u>

	Called up share capital £	Profit and loss account £	Share premium account £	2008 Total £	2007 Total £
COMPANY					
At 1 January 2008	2,116,680	(455,478)	7,244,356	8,905,558	8,868,575
Issue of shares	3,879,005	-	-	3,879,005	124,027
Issue costs	-	-	(170,621)	(170,621)	-
Credit to reserves for share based payments	-	47,459	-	47,459	143,974
Loss for the financial year	-	(944,013)	-	(944,013)	(231,018)
At 31 December 2008	<u>5,995,685</u>	<u>(1,352,032)</u>	<u>7,073,735</u>	<u>11,717,388</u>	<u>8,905,558</u>

18. OPERATING LEASE COMMITMENTS

As at 31 December 2008, the Group had annual commitments under non-cancellable operating leases as set out below:

	2008 £	2007 £
Leases which expire:		
Within one year		
- Land and buildings	85,036	-
Within one to two years		
- Plant and machinery	6,817	1,152
- Land and buildings	-	85,036
Within two to five years		
- Plant and machinery	1,754	6,817
	<u>93,607</u>	<u>93,005</u>

The Company had no operating lease commitments at either 31 December 2008 or 2007.

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19. RECONCILIATION OF OPERATING LOSS TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	2008 £	2007 £
Group operating loss	(2,216,280)	(3,858,500)
Depreciation, impairment and amortisation charge	329,244	366,935
Decrease/(increase) in stocks	85,443	(317,829)
(Increase)/decrease in debtors	(9,248)	947,867
(Decrease)/increase in creditors	(430,452)	68,105
Increase in provision	27,041	54,000
Share based payment charge	82,488	143,395
Disposal of investment in joint venture	-	6,101
Expenses settled by issue of shares	240,226	-
Transfer of fixed asset to stock	140,250	-
Foreign exchange	(94,023)	-
Net cash outflow from operating activities	<u>(1,845,311)</u>	<u>(2,589,926)</u>

20. ANALYSIS OF NET FUNDS

	At 1 January 2008 £	Cash flow £	At 31 December 2008 £
Cash at bank and in hand	334,352	273,189	607,541
Current asset investments - short term deposits	-	1,000,000	1,000,000
	<u>334,352</u>	<u>1,273,189</u>	<u>1,607,541</u>

21. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS

	2008 £	2007 £
Increase/(decrease) in cash in the year	273,189	(2,791,569)
Cash outflow from increase in liquid resources	1,000,000	-
Movement in net funds in the year	<u>1,273,189</u>	<u>(2,791,569)</u>
Opening net funds	334,352	3,125,921
Closing net funds	<u>1,607,541</u>	<u>334,352</u>

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22. POST BALANCE SHEET EVENTS

During October 2009, Keronite Group Limited raised funds of £670k (gross of expenses) through the issue of redeemable loan notes to existing shareholders. The funds were received during October 2009.

23. CONTROLLING PARTY

There are a number of shareholders of the Company, but no single party has control, therefore the directors are of the opinion that there is no controlling party.