No 06201882

**Business at a Glance**

Modern Water owns a portfolio of water technologies to address the limited availability of fresh water and the treatment and disposal of wastewater worldwide. By 2025, it is forecast that two-thirds of the world's population will live in countries classified as water-stressed. Climate change is likely to further exacerbate this situation.

Managed by an executive team with extensive experience in the water industry, Modern Water is at the leading edge of new and developing technologies, products and services, which are vital to the future sustainability of the world's most precious commodity.

Modern Water owns, installs and operates broad based membrane systems using world-leading Forward Osmosis (FO) membrane technologies; supplies packaged seawater Reverse Osmosis (RO) desalination systems; supplies wastewater treatment solutions; and develops and supplies advanced systems for water monitoring.

**Membrane division**
All Membrane Brine Concentration (Industrial)
Thermal Desalination (Industrial)
Evaporative Cooling Systems (Industrial)
Packaged SWRO Desalination Systems (Municipal & Industrial)
Wastewater Treatment (Municipal)

**Monitoring division**
Trace Metal Products
Toxicity Products
Environmental Products

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# Chairman's Statement

I am pleased to report that improvements at Modern Water have continued apace during the past year, resulting in a 12% increase in revenues and a 54% improvement in gross profits, both of which have been achieved whilst reducing our overheads by a further 11%, notwithstanding our continuing commitment to R&D and new product development.

Perhaps the most satisfying achievement I can report to shareholders is that our Monitoring division delivered positive EBITDA for the first time since the business was acquired in 2011, which is testament to the management changes we have made during the year. Sales in Monitoring increased by 8% and gross margins showed a substantial improvement to 50% (2015: 38%), primarily as a result of a better sales focus and product mix. Clearly, the strategy review we undertook in 2015 is bearing fruit and we are now in a position where we are working on a variety of new product developments which we believe will add to our portfolio and positively impact sales and profits as we move forward.

Our Membrane division continued to work with partners who have complementary skills, competencies and market coverage that can assist us in commercialising our proprietary membrane technology. As previously reported, we have been working closely with the likes of Advent Envirocare and Deutsche Babcock, both of whom offer us valuable additional market insight and support.

On that note, it was very pleasing to announce the award of a contract in February 2017 for the provision of our proprietary All Membrane Brine Concentration (AMBC) technology. Our innovative AMBC technology will be used to treat wastewater produced by an India-based customer involved in the textiles industry. The project will be executed in partnership with Advent Envirocare Technology during the course of 2017. Once commissioned, this plant will provide us with a fantastic shop window for our technology and will provide us with a springboard into other markets and geographies.

Our 2016 financial results show strong progress. Revenue and gross profit increased on the prior year, whilst overheads continued to reduce, resulting in an operating loss of £3.1m (2015: £4.2m). Cash burn in 2016 reduced to £2.0m (2015: £3.6m) and should reduce further in 2017. As at 31 December 2016, the Group's financial position was debt free, with cash of £1.1m (2015: £3.2m).

With an un-geared balance sheet, a cash generative Monitoring division, the Membrane division expected to break even in 2018 and a trade finance facility secured, we believe the Group now has the resources in place to become a genuinely sustainable, profitable business.

**Alan Wilson**
Non-Executive Chairman
14 March 2017

# Strategic Report

The Directors of Modern Water plc (Modern Water or the Company) and its subsidiary undertakings (which together comprise the Group) present their Strategic Report for the year ended 31 December 2016.

## Membrane Division

### Strategy

Over the last decade, the Membrane division has developed a wide range of IP, creating a Forward Osmosis (FO) platform from which a suite of products is being commercialised, a key example being the AMBC sale in February 2017. Each of the key technologies being focused upon in the near-term provides a solution that enables waste or unusable water to be desalinated or reused at a lower cost than alternative systems already in existence, whilst enabling customers to comply with regulatory requirements. We believe that there is clear demand for Modern Water's products and services in a number of different industrial processes and across a number of geographic territories globally, driven by increased legislation and regulation as governments try to address the growing global water crisis.

The Company has continued to pursue its key strategic goals and has made clear progress in the commercialisation of its technologies. The focus of the Company remains on its four market areas within a clear framework to:

- develop and commercialise our membrane technologies that have unique competitive advantage; and
- work with strategic partners, by product and territory, who have proven track records in the target sector, on joint development and commercialisation; risk sharing; licensing; and protecting and expanding our IP.

### All Membrane Brine Concentrator (AMBC)

The Group has developed and proven an All Membrane Brine Concentrator (AMBC) which can reduce the energy consumption and capital costs for achieving Zero Liquid Discharge or near Zero Liquid Discharge thereby reducing the cost of achieving regulatory compliance for wastewater treatment.

The technology is based on using successive stages of osmotically driven filtration to concentrate waste streams, and can be used across a wide range of industries.

In March 2016 Modern Water signed a joint development and commercialisation agreement with Advent Envirocare Technology, based in India. Following successful piloting of the technology in December 2016 the first commercial order was secured rapidly. In early February 2017 an agreement was reached to deploy our technology in a textile dye facility. A second AMBC trial in a different industrial sector is scheduled to commence in India later this year.

### Forward Osmosis (FO) Pre-treatment for Thermal Desalination

Modern Water has invented a Forward Osmosis process to allow an increase in the top brine temperature (TBT) of a typical Thermal Desalination plant by osmotic dilution of the re-circulating brine or brine blow-down. Through this patented and proprietary technology, on a typical multi-stage flash desalination (MSF) plant, the Group's technology can both improve the thermal efficiency by 12% and reduce power consumption by 27%. The technology is also flexible and can be alternatively optimised to increase the production of water from existing assets by 22%.

In January 2016, Modern Water signed a joint commercialisation agreement with Bilfinger Deutsche Babcock Middle East (BDB) for our proprietary Forward Osmosis technology. BDB is a leading services provider across the Middle East and Africa for the construction, rehabilitation, O&M and lifecycle services in a range of industries. Under the agreement, the two parties agreed to develop and commercialise Modern Water's Forward Osmosis technology for use in both existing and new build MSF desalination plants across the Middle East and Africa.

Following a joint design exercise, a pilot plant is being constructed by BDB in Abu Dhabi, with the first field trials due to take place in 2017. The purpose of the pilot plant is to develop and demonstrate the effectiveness of FO to osmotically dilute and soften the re-circulating brine of a desalination plant, consequently proving the benefits customers can expect.

### Forward Osmosis (FO) Evaporative Cooling Systems

The Company has continued to refine its technology to reduce the cost and environmental impact of traditional evaporative cooling systems. In line with our stated strategy for the membrane business, we are in discussion with a number of potential partners to undertake field tests of our technology in water-scarce regions.

**Aquapak**

AquaPak is a low cost containerised or skid mounted desalination plant using proven Reverse Osmosis (RO) technology. The units are manufactured in three standard capacities of $100m^3$, $250m^3$ and $500m^3$ per day of fresh water. The AquaPak units have been designed by Modern Water using its inherent technical knowhow and fabricated by a third party partner. The primary target market for AquaPak is the Gulf States, driven by the ever-increasing requirement for fresh water in remote locations.

As highlighted in our Interim Results statement of September 2016, the Company was awarded its first AquaPak contract in August 2016 by a client in Oman. The plant has been fabricated and delivered to Oman on schedule.

We continue to actively generate a significant number of enquiries and are pursuing a number of projects. We are confident of receiving further orders in the coming months.

**Wastewater Treatment**

The status of our joint venture with Northumbrian Water is unchanged from previous statements. We remain the preferred bidder for a wastewater project in Gibraltar. Modern Water has completed its current obligations and continues to assist in the project's advancement, with little in the way of ongoing costs being incurred by us.

This is a much needed infrastructure project for Gibraltar and is important in bringing the country up to international wastewater treatment standards. However, given the region's current challenge following the Brexit vote, uncertainty remains over potential timescales.

**Monitoring Division**

**Strategy and Performance Review**

Modern Water's Monitoring division has been built through a number of small acquisitions over the last decade. The division has a proven capability in the design, development and provision of analytical instruments and technologies for monitoring contaminants in water, soil, food and industrial process streams. These activities can be provided to clients either at a laboratory, on site or on-line, through a combination of direct and distributor sales channels. The Monitoring division's products and services are supplied to laboratories, industrial companies and municipalities across 60 countries globally. Revenue is generated through a combination of equipment sales and reagents/consumables.

Specifically, the Monitoring division is focused on three core product segments: Toxicity, Trace/Heavy Metals and Environmental contaminants, with a geographic focus on North America, China and Europe.

Doug Workman was appointed as President of the Monitoring division in March 2016 and has subsequently restructured the sales team, launched new products and consolidated all production and systems at the Monitoring division's head office in New Castle, Delaware, USA. Results so far have been very encouraging, with strong revenue growth delivered, alongside a highly attractive >50% gross margin.

The Monitoring division achieved a key milestone in 2016, reporting positive EBITDA of £60,000 (2015: loss of £508,000). Adjusting for the expected recovery of 2016 R&D tax credits would improve this further. This is the first positive EBITDA achieved by the division since 2012. The two key factors in achieving this milestone were an 8% growth in revenue and an improvement in gross margins to 50% (2015: 38%). The growth in margin was due to an increased focus on direct sales, improved shipping cost recoveries, strong sales of consumables and reagents and consolidation of production to a single site.

Recurring revenue from service contracts and reagent sales was £1.1m in 2016 (2015 £1m).

**Group Key Performance Indicators (KPIs)**

At the Company's current stage of development the Directors consider that strategic and operational progress is best measured by achievement in terms of technical and business development milestones and at this stage does not monitor non-financial KPIs. In 2016 we achieved progress against our goals and will continue to focus on these elements to drive future growth. In 2016 the key milestones reached were:

- The first sale for our AMBC technology
- The first sale of our AquaPak product
- Continued revenue growth in the Monitoring division

Further details of strategic and operational progress for the two main operating divisions are outlined in the Membrane and Monitoring sections of this Strategic Report. The Board reviews strategic, operational and financial information on a monthly basis to measure progress. The key financial performance indicators for 2016, covered in more detail in the Financial Review and the financial statements, were:

- Revenue increased 12% to £3.6m (2015: £3.2m);
- Gross profit grew 54% to £1.9m (2015:£1.2m);
- Operating loss before tax, interest, depreciation, amortisation decreased to £2.5m (2015: £3.7m);
- Total comprehensive loss for the year reduced to £2.2m (2015: £3.9m)
- Cash outflow decreased to £2.0m (2015: £3.6m); and
- Cash as at 31 December 2016 was £1.1m (2015: £3.2m).

**Group Research & Development (R&D)**

The Group continues to invest in R&D across membrane, wastewater and monitoring technologies to support the development and delivery of commercial products for customers and expand the patent portfolio of the Group. Expenditure recorded in the Statement of Comprehensive Income for R&D during the year was £200,000 (2015: £156,000). The Group has benefited from the HMRC R&D tax credits scheme with the receipt of £0.5m in cash from claims made in 2016, related to R&D expenditure in 2013, 2014 and 2015. The Group will submit claims for the recovery of 2016 R&D expenditure to HMRC in 2017.

**Group Patent Portfolio & Intellectual Property**

As part of our active patent management we have decided to abandon patent coverage in some strategically unimportant jurisdictions, thereby achieving cost savings.

As a result our patent portfolio in the Membrane division now consists of 89 (2015: 104) granted patents across eight main patent families comprising solvent removal, improved solvent removal, secondary oil recovery, osmotic energy, separation process, evaporative cooling, cooling tower improvements and thermal desalination. The Monitoring division currently holds 13 granted patents (2015: 18) and Modern Water has 5 (2015: 7) innovative wastewater treatment patents. Altogether the Group holds 107 granted patents (2015: 129) with a further 22 pending applications (2015: 29).

**Group Resources**

Modern Water strives to create a community, not just a workplace, and makes an effort to encourage collaboration and networking across the Group. We also support the ongoing development of our employees and have an excellent track record in the retention of key employees.

Our strategy of employing local workers wherever we operate continued during 2016, especially in Oman where our operations continue to be 100% locally managed with support from our central technical team. Both our Membrane and Monitoring divisions have adopted this strategy, which is working well.

As at 31 December 2016 the Group employed 44 permanent staff (2015: 49), supplemented by contract staff as required.

**Group Financial Review**

*Summary*

The Group had £1.1m cash in the bank and no debt at 31 December 2016 (2015: £3.2m cash) and has subsequently put a trade finance facility of £0.5m in place. During the year the Group as a whole continued to incur losses, reflecting the early stage of commercial roll out of the Membrane division, however the Monitoring division broke even at the EBITDA level. The overall loss before interest, tax, depreciation and amortisation reduced to £2.5m (2015: £3.7m). The reduction on the prior year losses was primarily due to a further reduction in operating costs during 2016, and an improvement in gross margin from the Monitoring division. The ongoing reorganisation, started in 2015, has now removed over £1.4m of administrative expenses.

The Group generated revenues of £3.6m in 2016 (2015: £3.2m). Total comprehensive loss reduced to £2.2m (2015: £3.9m).

*Cash Flows*

The Group cash outflow, for the year was £2.0m (2015: £3.6m). This reduction in cash burn was due to the increase in gross profit, reduction in operating expenses and an improvement in working capital movement during the year.

Cash inflow from R&D tax credits was £0.5m (2015: £0.1m). Cash outflows comprised £0.1m on property, plant and equipment (2015: £0.1m), £0.1m on patents (2015: £0.1m) and £2.0m on operating activities (2015: £3.5m).

*Accounting Policies*
The Group financial statements have been prepared in accordance with EU Endorsed IFRS, IFRS Interpretations Committee (IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The key accounting policies to note are those concerned with intangible assets and share-based payments.

*Capital Structure*
The Group is entirely equity funded which is appropriate during the current stage of development. As the Group develops, the capital structure will be reassessed on a project by project basis.

*Treasury Management*
The Group has adopted a low risk approach to treasury management. Cash balances are invested in instant access current and deposit accounts. Credit risk is addressed by the Group's treasury policy. Deposits are selected based on achieving the optimum balance of yield, security and liquidity. Foreign exchange risk is primarily mitigated through natural hedging of receipts and payments. See note 3 to the Accounts for further detail of financial risk management.

**Going Concern**
The directors are required by company law to be satisfied that the Group has adequate resources to continue in business for the foreseeable future. A review has been conducted and the directors have concluded that such resources are available, and that the going concern basis is justified in preparation of the financial statements.

The Group's forecasts prepared by the directors reflect that funding requirements have reduced since 2015, as the result of the restructuring plan, delivering an annual net £1.4m reduction in expenditure. The cash position as at 31 December 2016 was £1,072,000 and as of 9 March 2017 stood at £906,000. The Group remains loss making, but its cash burn is expected to decrease further through 2017 and 2018 as revenues increase and the full year effect of 2016 cost reductions impact.

The Group's funding requirements will be met from:
- £0.9m opening cash balance as of 9 March 2017;
- R&D tax credits receipts from HMRC for 2016;
- £0.5m credit line secured on Modern Water Inc.'s trade receivables;
- favourable movement in the Group's working capital, specifically a reduction in inventories and aged trade receivables in the Monitoring division; and
- first meaningful revenues from the commercialisation of the Membrane division's technology.

In addition, Modern Water is pursuing a number of commercial opportunities, which would provide incremental positive cash inflows, the most significant of which is the joint venture between Modern Water and Northumbrian Water, where our JV has preferred bidder status and has satisfied all its responsibilities and obligations.

**Principal Risks and Uncertainties**
The principal risks inherent in the operation of the Group are well understood by the Board of Directors and the Management Team. Control measures have been established to ensure that these, and other, risks are adequately controlled both in terms of frequency and consequence. The internal control environment is described in the Corporate Governance Statement. The principal risks and uncertainties affecting the Group and the steps taken to manage these are:

*Customer acceptance of the Group's technologies and emergence of competing technologies*
The Group's success depends on potential customer acceptance of its products and processes. There are significant risks in predicting the size and timing of material revenue. The target customers of the Group's products and processes are often in developing countries which carry additional potential risks. The Group seeks to address these risks by building a track record and proving technology capabilities to future customers and industry players. The Group has increased investment in business development as product development progresses. Modern Water has formed a number of strategic partnerships to create local presence in target countries, overcome pre-qualification criteria on contract tendering and establish new routes to market. The range of applications for the Group's products provides mitigation against the risk of failure in a specific country or application. The Group continues to invest in research and development (R&D) to mitigate the risk of the emergence of competitor technologies.

# Strategic Report

*Socio-political risks*
Modern Water operates, and is looking to secure further contracts and sales, in a number of countries around the world. This exposes the Group to a range of social and political developments and consequentially to potential changes in the operating, regulatory and legal environment. The Group operates and generates revenue in countries where political, economic and social transition is taking place. Some countries have experienced, or may experience in the future, political instability, changes to the regulatory environment, changes in taxation, expropriation or nationalisation of property, civil strife, strikes, acts of war and insurrections. Any of these conditions occurring could disrupt our operations and revenue. The Group seeks to manage these risks through diversifying the regions in which it operates.

*Scaling up the technology*
The Group's Membrane division and certain monitoring products are not yet well established commercially. They have been developed over recent years and whilst the proving of the technology is largely complete there remain significant risks associated with commercialising technology and a portfolio of new products. There are technology and procurement risks in scaling up the products through to large scale commercial deployment. The Group seeks to mitigate these risks through the use of partners with proven manufacturing and fabrication capabilities, rather than developing in-house capabilities, and through the development and operation of pilot plants prior to full commercial deployment.

Additionally there are risks related to developing the optimum contract, royalty and licensing models to derive value from the products. The Group manages these risks through employment of executives and senior management with significant experience both in the water industry and in the development and growth of early stage companies.

*Intellectual Property (IP) protection*
The Group's ability to generate value from its products depends in part on the development and protection of its IP. The Group assigns significant resources, both internally through the Company's General Counsel and technical staff, and externally through patent attorneys, to enhance and protect its patented and non-patented IP.

*Recruitment and retention of key personnel*
The Group's directors and employees are highly qualified and experienced. Recruiting and retaining key staff is critical to the overall success. Knowledge and experience of the Group's products and customer base is retained by a relatively small number of individuals. The risk of staff loss is mitigated through its HR policies, competitive remuneration (including the Modern Water plc Incentive Plan), performance appraisals and training.

*Health and safety*
There are inherent health and safety risks with the deployment of the core membrane and monitoring products. The mitigation of any health and safety events involving the Group's products is key to the strategy for growth. The Group mitigates its health and safety risks through its Group Health and Safety Policy, which includes regular reporting to the Board and to the Management Team.

*Capital risks*
It may be desirable for the Company to raise additional capital by way of the further issue of Ordinary Shares to enable the Company to progress through further stages of development. Any additional equity financing may be dilutive to shareholders. There can be no assurance that such funding, if required, will be available to the Company.

*Financial risks*
These risks and mitigating controls are described in note 3 to the Accounts.

The Strategic Report was approved by the Board of Directors on 14 March 2017 and signed on its behalf by:

**Simon Humphrey**
*Chief Executive Officer*
14 March 2017

# Corporate Governance Statement

### Corporate Governance

The Board of Modern Water plc is committed to integrity, business ethics and achieving good standards of *corporate governance. As permitted under AIM rules, Modern Water plc has not complied with the UK Corporate* Governance Code (the "Code"). However, this Corporate Governance Statement, together with the information contained in the Directors' Remuneration Report on pages 9 to 10, explains how the directors seek to apply the requirements of the Code to the Group, where practical given its size, resources and stage of development.

### Board of Directors

The Board comprises one executive director, the Chief Executive Officer (Simon Humphrey), and two non-executive directors (Alan Wilson and Mike Townend). Alan Wilson was appointed on 1 May 2015 as independent non-executive Chairman. Mike Townend is a representative of IP Group plc. Alan Wilson is the Interim Chairman of both the Audit and Remuneration Committees.

The business and management of the Group and its subsidiaries are the collective responsibility of the Board. At each meeting the Board considers and reviews the performance of each of the major projects. The Board has a formal written schedule of matters reserved for its review and approval. These include the approval of the annual budget, major capital expenditure, investment proposals, the interim and annual results, and a review of the overall system of internal control and risk management.

Authority for the execution of the approved policies, business plan and daily running of the business is delegated to the Chief Executive Officer. In addition, there is a management team whose purpose is to assist the Chief Executive Officer in the performance of his duties.

Modern Water plc's Articles of Association require one-third of the directors to stand for re-election each year at the Annual General Meeting. Accordingly, Mike Townend will retire and offer himself for re-election at the forthcoming Annual General Meeting.

All directors have access to the advice and services of the Company Secretary who is responsible for ensuring that board procedures and applicable rules and regulations are observed. The Board has a procedure whereby any director may seek, through the office of the Company Secretary, independent professional advice, at the Group's expense, in furtherance of his duties.

*Formal agendas and reports are provided to the Board on a timely basis for board and committee meetings and* the Chairman ensures that all directors are properly briefed on issues to be discussed at board meetings. Directors are able to obtain further advice or seek clarity on issues raised at the meetings from within the Group or from external sources.

### Business Ethics

We are committed to acting fairly and ethically in all countries in which we operate. We expect the same standards from all third parties who provide services for Modern Water plc and its subsidiary companies. We maintain anti-bribery, gifts and entertainment policies, and procedures for contractual commitments to better manage risk with third parties.

### Committees

The Board has a Remuneration Committee and an Audit Committee. The executive director is not a member of the committees, but attends the meetings by invitation to facilitate business, if appropriate. The Company Secretary acts as secretary to the committees. The Board does not have a Nomination Committee and Board appointments are consequently a matter for the Board as a whole. The Board is satisfied that the committees discharged their responsibilities appropriately.

### Remuneration Committee

The Remuneration Committee consists of Alan Wilson (Interim Chairman) and Mike Townend. Further details of the committee and its policies are set out in the Directors' Remuneration Report on pages 9 to 11.

### Audit Committee

The Audit Committee consists of Alan Wilson (Interim Chairman) and Mike Townend.

The committee reviews and makes recommendations on the appointment, reappointment and removal of the external auditor, the review of the scope and results of the external annual audit by the auditor, the auditor's cost effectiveness, independence and objectivity. The committee also reviews the nature and extent of any non-audit services provided by the external auditor. No independence issues were noted during the year. The Group's Finance Director monitors the level and nature of non-audit services and specific assignments are identified for approval by the Audit Committee as appropriate.

In addition, the Audit Committee reviews the effectiveness of internal controls, considers the need for an internal audit function and considers any major accounting issues, and reports on such matters to the Board. The Audit Committee reviews the integrity of the financial statements and formal announcements.

A whistle-blowing arrangement exists whereby matters can be confidentially reported to the committee.

**Attendance**

The following table shows attendance of the directors at meetings of the Board, Remuneration and Audit Committees during the year:

| | Board | | Remuneration | | Audit | |
|---|---|---|---|---|---|---|
| | Attended | Eligible to attend | Attended | Eligible to attend | Attended | Eligible to attend |
| Alan Wilson | 8 | 8 | 2 | 2 | 2 | 2 |
| Simon Humphrey | 8 | 8 | - | - | - | - |
| Mike Townend | 8 | 8 | 2 | 2 | 2 | 2 |

**Internal Control**

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The implementation and maintenance of the risk management and internal control systems are the responsibility of the executive director and senior management. The internal control system is designed to mitigate the principal risks, amongst others, detailed in the Directors' Report, but it does not provide absolute assurance that these risks are eliminated or against material misstatement or loss. The Board is satisfied with the controls in place for identification and management of risk and that the reporting lines have been in place throughout the year under review. The key internal controls in place during the year and up to the date of approval of the report included:

- reporting to the Board, including key financial information and commentary (Group Statement of Comprehensive Income, Group Statement of Financial Position, Group Statement of Cash Flows) and the Chief Executive Officer's report on the business, significant changes and the external marketplace, including the extent to which they represent significant risk;
- detailed corporate policies and procedures document to address key operating and compliance risk areas, including procurement, treasury, human resources, health and safety;
- clear organisational structure with defined reporting lines and delegated authorities;
- the Audit Committee;
- centralised accounts team providing financial control and support to all Group companies; and
- an annual strategy review and an annual budget approved by the Board.

The Board has considered the need for an internal audit function, but because of the size and nature of its operations does not consider it necessary at the current time.

**Relations with Shareholders and Investors**

The Board is regularly updated regarding meetings and communications with shareholders. An analysis of the shareholder base is presented to the Board on a quarterly basis. Research notes and broker analysis are circulated to and discussed with the Board. During the year, various meetings with institutional investors were arranged by the Group's brokers and financial PR advisers.

Copies of the Annual Report and Accounts are issued to all shareholders and together with the Interim Statement are available on the Group's website: www.modernwater.com. The Group makes full use of its website to provide information to shareholders and other interested parties. The website provides a facility to receive email alert notifications of Group news and regulatory announcements to the London Stock Exchange. Shareholders are given the opportunity to raise questions at the Annual General Meeting and the directors are available both prior to and after the meeting for further discussion with shareholders. Alan Wilson, as Chairman, is available to shareholders where contact through the normal channels of Chief Executive Officer or Company Secretary is inappropriate or has failed to resolve concerns.

# Directors' Remuneration Report

**Introduction**

This report has been approved by the Board and the Remuneration Committee (the 'Committee'). It has been prepared to comply with the disclosure requirements of Schedule 5 to the Large and Medium Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The report also provides the information required to be reported on directors' remuneration under AIM Rule 19. The Committee is committed to maintaining high standards of corporate governance and has taken steps to comply with the principles of best practice, including the ABI Principles of Remuneration and The UK Corporate Governance Code in so far as they can be applied practically given the size of the Group.

**Role of the Remuneration Committee**

The Committee determines, in accordance with its terms of reference, the remuneration and other benefits, including bonuses and share-based payments, of the executive director.

The Committee consulted with the executive director about its remuneration proposals for the year.

**Remuneration Policy**

The Committee is aware that the remuneration package should be sufficiently competitive to attract, retain and motivate individuals capable of achieving the Group's objectives and thereby enhancing shareholder value. Performance-based remuneration should be clearly aligned with business strategy and objectives and be regularly reviewed. Overall arrangements should be prudent, well communicated, incentivise effectively and recognise shareholders' expectations.

**Service Contracts**

The Group's policy is for executive directors to have service contracts with provision for termination of no more than 12 months' notice.

Alan Wilson has a letter of appointment. Appointments can be terminated by the Group or the individual giving one month's notice. The services of Mike Townend are covered in a services agreement with IP Group plc, a significant shareholder in the Company.

The details of the executive and non-executive directors' service contracts during the year are summarised below:

| | Director | Date of contract | Notice period (months) |
|---|---|---|---|
| **Directors during the year and up to the date of approval of the financial statements** | | | |
| Simon Humphrey | Chief Executive Officer | 18 May 2007 | 12 |
| Alan Wilson | Independent Non-executive Chairman | 26 March 2015 | 1 |
| Mike Townend | Non-executive | 18 May 2007 | 1 |

**Directors' Remuneration**

Remuneration for the executive director comprises basic salary, pension and insurance cover for medical, life and income protection.

The Board, within the limits stipulated by the Articles of Association and with recommendation from the executive directors, determines non-executive directors' fees. The remuneration of the non-executive directors is not pensionable and the non-executive directors do not participate in any of the Group's other remuneration schemes.

# Directors' Remuneration Report

Remuneration for the directors during the year was as follows:

| | Basic salary, allowances and fees | * Bonus | Benefits | Year ended 31 December 2016 Total (ex pension) | Pension | Year ended 31 December 2016 Total (inc pension) | Year ended 31 December 2015 Total (ex pension) | Pension | Year ended 31 December 2015 Total (inc pension) |
|---|---|---|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| **Executive directors** | | | | | | | | | |
| Simon Humphrey | 138 | — | 4 | 142 | 14 | 156 | 142 | 14 | 156 |
| **Non-executive directors** | | | | | | | | | |
| Alan Wilson | 60 | — | — | 60 | — | 60 | 40 | — | 40 |
| Michael Gradon | — | — | — | — | — | — | 35 | — | 35 |
| Robert Clarke | — | — | — | — | — | — | 22 | — | 22 |
| Mike Townend** | — | — | — | — | — | — | — | — | — |
| | 198 | — | 4 | 202 | 14 | 216 | 239 | 14 | 253 |

* Bonuses are disclosed in the year for which the performance relates. There were no bonuses in relation to 2015 or 2016 annual performance.

** The services of Mike Townend are covered through an agreement with IP Group plc, see note 25 to the Accounts.

**Modern Water plc Incentive Plan ('MWIP')**

The MWIP contains provisions relating to the making of awards in the form of options and conditional awards of ordinary shares.

***a) Options***

During the current year no options under the MWIP were granted, vested, exercised or lapsed for Simon Humphrey. There are vested options outstanding over 373,918 shares. However, since vesting the Company's share price has been lower than the option exercise price and accordingly these options had not been exercised at 31 December 2016. They will lapse if they remain unexercised as at 12 June 2017.

| | Grant date | Vesting date | Outstanding at 1 January 2016 number | Outstanding at 31 December 2016 number | *Vested and* exercisable at 31 December 2016 number | Option price | Charge to income statement in 2016 | Charge to income statement in 2015 |
|---|---|---|---|---|---|---|---|---|
| Simon Humphrey | 6.6.07 | 12.6.10 | 373,918 | 373,918 | 373,918 | £1.19 | £nil | £nil |

**Directors' Interests**

Directors' interests are detailed in the Directors' Report.

**Share Price**

The Modern Water plc closing share price was 6.25p on 31 December 2016. The share price high for 2016 was 8.00p and the low was 4.55p.

On behalf of the Board

**Alan Wilson**
**Interim Chairman, Remuneration Committee**
14 March 2017

# Directors' Report

The directors present their Annual Report together with the audited consolidated financial statements for the year ended 31 December 2016.

**Corporate Structure**

The Company is incorporated in England and Wales and has subsidiaries principally incorporated in England and Wales, as well as in China, Oman and the USA.

**Review of the Business and Results**

A detailed review of the business is set out in the Strategic Report on pages 2 to 6. This includes comments on the financial performance and position of the Group. Information on the Group's internal control environment, including the content of reporting to the Board, is included in the Corporate Governance Statement on pages 7 to 8.

**Research and Development and Future Developments**

Research and Development and future developments and prospects are set out in the Strategic Report.

**Dividends**

The directors do not recommend the payment of a dividend (2015: £nil). At this point in the Company's development, the directors look to invest capital in areas designed to achieve the Group's plan for growth, although clearly this matter is kept under constant review.

**Directors' Interests**

The directors in office during the year and up to the date of signing the financial statements are listed below together with their beneficial interests in the share capital of the Company.

| | % of issued share capital<br>31 December 2016 | Number of ordinary shares of 0.25p<br>31 December 2016 |
|---|---|---|
| Simon Humphrey | 2.30 | 1,832,000 |
| Mike Townend | 0.76 | 605,000 |

**Directors' and Officers' Liability Insurance**

The Group maintains liability insurance for its directors and officers. The Group has also provided an indemnity for its directors and the secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006. This provision was in place during the year and up to the date of the Annual Report and Accounts.

**Corporate Governance**

The Annual Report includes a separate section that describes the Group's approach to applying the principles of best practice associated with corporate governance.

**Financial Instruments**

The Group's financial instruments primarily comprise cash and cash equivalents. In addition, various other financial instruments such as trade receivables and trade payables arise directly from its operations. Please refer to note 3 to the Accounts for greater details of the Group's risks and policies regarding financial instruments.

**Annual General Meeting**

The Annual General Meeting will be held at the offices of Modern Water plc on 25 April 2017 at 10.00 am.

**Independent Auditor**

During the year Grant Thornton UK LLP was appointed as independent auditor following a tender process. Grant Thornton UK LLP has indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the Annual General Meeting.

# Directors' Report

**Directors' Statement as to Disclosure of Information to Auditor**

The directors who were members of the Board at the time of approving the Directors' Report are listed on page 9. Having made enquiries of fellow directors, each of these directors confirms that:

- so far as each director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- the directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditor is aware of that information

By order of the Board

**Toby Schumacher**
**Company Secretary**
14 March 2017

# Statement of Directors' Responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs and profit or loss of the company and group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and 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 included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**By order of the board**

**Toby Schumacher**
**Company Secretary**
14 March 2017

# Independent Auditor's Report

to the members of Modern Water plc

We have audited the financial statements of Modern Water plc for the year ended 31 December 2016 which comprise the group statement of comprehensive income, the group and company statements of financial position, the group and company statements of changes in equity, the group and company statements of cash flow, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's 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 auditor***

As explained more fully in the Directors' Responsibilities Statement set out on page 13, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

**Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2016 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

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

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.
- the Strategic Report and Directors' Report has been prepared in accordance with applicable legal requirements.

**Matter on which we are required to report under the Companies Act 2006**

In the light of the knowledge and understanding of the group and parent company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and Directors' Report.

# Independent Auditor's Report

to the members of Modern Water plc

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

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Nicholas Watson
Senior Statutory Auditor
for and on behalf of Grant Thornton UK LLP
Statutory Auditor, Chartered Accountants
London

14 March 2017

# Group Statement of Comprehensive Income

for the year ended 31 December 2016

| | Note | 2016<br>Total<br>£000 | 2015<br>Total<br>£000 |
|---|---|---|---|
| Revenue | 5 | **3,629** | 3,232 |
| Cost of sales | 5 | **(1,764)** | (2,024) |
| ***Gross profit*** | 5 | **1,865** | 1,208 |
| Administrative expenses | 7 | **(4,414)** | (4,936) |
| Other gains - net | 6 | **—** | 18 |
| **Operating loss before depreciation and amortisation** | | **(2,549)** | (3,710) |
| Depreciation and amortisation | 7 | **(502)** | (527) |
| **Operating loss** | | **(3,051)** | (4,237) |
| Finance income | 11 | **514** | 210 |
| Finance costs | 11 | **(30)** | — |
| **Loss on ordinary activities before taxation** | | **(2,567)** | (4,027) |
| Taxation | 12.1 | **465** | 249 |
| **Loss for the year** | | **(2,102)** | (3,778) |
| **Other comprehensive income** | | | |
| Foreign currency translation differences on foreign operations | | **(76)** | (93) |
| **Total comprehensive loss for the year** | | **(2,178)** | (3,871) |
| | | | |
| **Loss attributable to:** | | | |
| Owners of the parent | | **(2,102)** | (3,778) |
| | | **(2,102)** | (3,778) |
| | | | |
| **Total comprehensive loss attributable to:** | | | |
| Owners of the parent | | **(2,211)** | (3,871) |
| Non-controlling Interest | | **33** | — |
| | | **(2,178)** | (3,871) |
| | | | |
| **Earnings / (Loss) per share for the year (attributable to owners of the parent):** | | | |
| Basic earnings / (loss) per share | 13.1 | **(2.64p)** | (4.75p) |
| Diluted earnings / (loss) per share | 13.2 | **(2.64p)** | (4.75p) |

Modern Water plc has taken advantage of the exemption provided under Section 408 of the Companies Act 2006 not to disclose the parent company statement of comprehensive income.

The notes on pages 20 to 44 are an integral part of these consolidated financial statements.

# Group and Company Statements of Financial Position

as at 31 December 2016

| | Note | Group 2016 £000 | Group 2015 £000 | Company 2016 £000 | Company 2015 £000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Non-current assets** | | | | | |
| Property, plant and equipment | 14 | **255** | 339 | — | — |
| Intangible assets | 15 | **3,388** | 3,647 | — | — |
| Investments | 16 | — | — | **1,730** | 1,628 |
| | | **3,643** | 3,986 | **1,730** | **1,628** |
| **Current assets** | | | | | |
| Inventories | 17 | **1,319** | 1,459 | — | — |
| Trade and other receivables | 18 | **1,559** | 1,046 | **5,567** | 4,141 |
| Cash and cash equivalents | 19 | **1,072** | 3,161 | **419** | 2,218 |
| | | **3,950** | **5,666** | **5,986** | **6,359** |
| **Total assets** | | **7,593** | **9,652** | **7,716** | **7,987** |
| | | | | | |
| **Equity and liabilities** | | | | | |
| **Equity** | | | | | |
| Ordinary shares | 23 | **199** | 199 | **199** | 199 |
| Share premium account | 23 | **40,032** | 40,032 | **40,032** | 40,032 |
| Merger reserve | | **398** | 398 | **398** | 398 |
| Foreign exchange reserve* | | **(248)** | (139) | — | — |
| Accumulated losses* | | **(33,629)** | (31,634) | **(33,009)** | (32,722) |
| | | **6,752** | **8,856** | **7,620** | **7,907** |
| Non-controlling interests | | **159** | 126 | — | — |
| **Total equity** | | **6,911** | **8,982** | **7,620** | **7,907** |
| | | | | | |
| **Liabilities** | | | | | |
| **Non-current liabilities** | | | | | |
| Deferred tax liabilities | 12.3 | **29** | 42 | — | — |
| **Current liabilities** | | | | | |
| Trade and other payables | 20 | **653** | 628 | **96** | 80 |
| | | **653** | **628** | **96** | **80** |
| **Total liabilities** | | **682** | **670** | **96** | **80** |
| **Total equity and liabilities** | | **7,593** | **9,652** | **7,716** | **7,987** |

*2015 figures have been restated to disclose the foreign exchange reserve separately from accumulated losses.

The loss attributed to the parent company in the year was £394,000 (2015 loss of: £6,590,000).

The notes on pages 20 to 44 are an integral part of these consolidated financial statements.

The financial statements on pages 16 to 44 were approved by the Board of Directors on 14 March 2017 and signed on its behalf by:

**Simon Humphrey**
**Chief Executive Officer**
14 March 2017
Modern Water plc

Registered number: 05963927

# Group and Company Statements of Changes in Equity

for the year ended 31 December 2016

| Group | Note | Ordinary shares £000 | Share premium Account £000 | Merger reserve £000 | Foreign exchange Reserve* £000 | (Accumulated losses)/ Retained Earnings* £000 | Total £000 | Non-controlling interest £000 | Total Equity £000 |
|---|---|---|---|---|---|---|---|---|---|
| **Balance as at 1 January 2015** | | **199** | **40,032** | **398** | **(46)** | **(27,912)** | **12,671** | **126** | **12,797** |
| **Comprehensive loss** | | | | | | | | | |
| Loss for the year | | — | — | — | — | (3,778) | (3,778) | — | (3,778) |
| Foreign currency translation differences | | — | — | — | (93) | — | (93) | — | (93) |
| Total comprehensive loss | | — | — | — | (93) | (3,778) | (3,871) | — | (3,871) |
| **Transactions with owners** | | | | | | | | | |
| Share-based payments | 9 | — | — | — | — | 56 | 56 | — | 56 |
| Total transactions with owners | | — | — | — | — | 56 | 56 | — | 56 |
| **Balance as at 1 January 2016** | | **199** | **40,032** | **398** | **(139)** | **(31,634)** | **8,856** | **126** | **8,982** |
| **Comprehensive loss** | | | | | | | | | |
| Loss for the year | | — | — | — | — | (2,102) | (2,102) | — | (2,102) |
| Foreign currency translation differences | | — | — | — | (109) | — | (109) | 33 | (76) |
| Total comprehensive loss | | — | — | — | (109) | (2,102) | (2,211) | 33 | (2,178) |
| **Transactions with owners** | | | | | | | | | |
| Share-based payments | 9 | — | — | — | — | 107 | 107 | — | 107 |
| Total transactions with owners | | — | — | — | — | 107 | 107 | — | 107 |
| **Balance as at 31 December 2016** | | **199** | **40,032** | **398** | **(248)** | **(33,629)** | **6,752** | **159** | **6,911** |
| | | | | | | | | | |
| Company | | | | | | | | | |
| **Balance as at 1 January 2015** | | **199** | **40,032** | **398** | — | **(26,188)** | **14,441** | — | **14,441** |
| **Comprehensive loss** | | | | | | | | | |
| Loss and total comprehensive loss for year | | — | — | — | — | (6,590) | (6,590) | — | (6,590) |
| Total comprehensive loss | | — | — | — | — | (6,590) | (6,590) | — | (6,590) |
| **Transactions with owners** | | | | | | | | | |
| Share-based payments | 9 | — | — | — | — | 56 | 56 | — | 56 |
| Total transactions with owners | | — | — | — | — | 56 | 56 | — | 56 |
| **Balance as at 1 January 2016** | | **199** | **40,032** | **398** | — | **(32,722)** | **7,907** | — | **7,907** |
| **Comprehensive loss** | | | | | | | | | |
| Loss and total comprehensive loss for year | | — | — | — | — | (394) | (394) | — | (394) |
| Total comprehensive loss | | — | — | — | — | (394) | (394) | — | (394) |
| **Transactions with owners** | | | | | | | | | |
| Share-based payments | 9 | — | — | — | — | 107 | 107 | — | 107 |
| Total transactions with owners | | — | — | — | — | 107 | 107 | — | 107 |
| **Balance as at 31 December 2016** | | **199** | **40,032** | **398** | — | **(33,009)** | **7,620** | — | **7,620** |

*The 2015 figures have been restated to disclose the foreign exchange reserve separately from accumulated losses.

The notes on pages 20 to 44 are an integral part of these consolidated financial statements. The Merger reserve balance as at 31 December 2016 relates solely to the 2011 acquisition of Cogent Environmental Limited.

# Group and Company Statements of Cash Flows

for the year ended 31 December 2016

| | | Group | | Company | |
|---|---|---|---|---|---|
| | | **2016** | 2015 | **2016** | 2015 |
| | Note | **£000** | £000 | **£000** | £000 |
| **Cash flows from operating activities** | | | | | |
| Cash used in operations | 24 | **(1,974)** | (3,487) | **(1,809)** | (3,475) |
| **Net cash flows used in operating activities** | | **(1,974)** | (3,487) | **(1,809)** | (3,475) |
| **Cash flows from investing activities** | | | | | |
| Purchase of property, plant and equipment | 14 | **(70)** | (109) | **—** | — |
| Purchase of patents and development costs | 15 | **(44)** | (54) | **—** | — |
| Interest received | | **4** | 20 | **4** | 20 |
| **Net cash flows (used in)/generated from investing activities** | | **(110)** | (143) | **4** | 20 |
| **Cash flows from financing activities** | | | | | |
| Proceeds from issuance of ordinary shares | | **—** | — | **—** | — |
| **Net cash flows generated from financing activities** | | **—** | — | **—** | — |
| Net (decrease) /increase in cash and cash equivalents | | **(2,084)** | (3,630) | **(1,805)** | (3,455) |
| Cash and cash equivalents at the beginning of the year | 19 | **3,161** | 6,801 | **2,218** | 5,666 |
| Exchange (losses) / gains on bank balances | | **(5)** | (10) | **6** | 7 |
| **Cash and cash equivalents at the end of the year** | 19 | **1,072** | 3,161 | **419** | 2,218 |

The notes on pages 20 to 44 are an integral part of these consolidated financial statements. 2015 has been restated to disclose R&D tax credit receipts as a component of cash flow from operating activities.

# Notes to the Consolidated Financial Statements

**1. General information**
Modern Water plc is a public limited company incorporated and domiciled in England and Wales, whose shares are publicly traded on the Alternative Investment Market (AIM), a market operated by the London Stock Exchange. The registered office and principal place of business is Bramley House, The Guildway, Old Portsmouth Road, Guildford, Surrey GU3 1LR.

The consolidated and Company financial statements of Modern Water plc (the 'Company') and its subsidiaries (together the 'Group') for the year ended 31 December 2016 were authorised for issue by the Board of directors on 14 March 2017 and the statement of financial position was signed by the Chief Executive Officer (Simon Humphrey).

The principal accounting policies adopted by the Group and Company are set out below.

**2. Summary of significant accounting policies**
The principal accounting policies have been applied consistently throughout the current and prior year, unless otherwise stated, in the preparation of these financial statements.

***2.1 Basis of preparation and changes in accounting policy and disclosures***
The financial statements of Modern Water plc have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU, IFRS Interpretations Committee (IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Under Section 479A of the Companies Act 2006, exemptions from an audit of the accounts for the financial year ended 31 December 2016 have been taken by Aguacure Ltd (05893786), Cymtox Limited (05025552), Modern Water Monitoring Limited (06701882), Modern Water Services Limited (06316697), MW Monitoring Limited (07495046), MW Monitoring IP Limited (07810737), Modern Water Holdings Limited (07588452), Poseidon Water Limited (04598478) and Surrey Aquatechnology Limited (05698169). As required, the Company guarantees all outstanding liabilities to which the subsidiary companies listed above are subject at the end of the financial year, until they are satisfied in full and the guarantee is enforceable against the parent undertaking by any person to whom the subsidiary companies listed above is liable in respect of those liabilities.

***2.1.1 Going concern***
The directors are required by company law to be satisfied that the Group has adequate resources to continue in business for the foreseeable future. A review has been conducted and the directors have concluded that such resources are available, and that the going concern basis is justified in preparation of the financial statements.

The Group's forecasts prepared by the directors reflect that funding requirements have reduced since 2015, as the result of the restructuring plan, delivering an annual net £1.3m reduction in expenditure. The cash position as at 31 December 2016 was £1,072,000 and as of 9 March 2017 stood at £906,000. The Group remains loss making, but its cash burn is expected to decrease further through 2017 and 2018 as revenues increase and the full year effect of 2016 cost reductions impact.

The Group's funding requirements will be met from:
- £0.9m opening cash balance as of 9 March 2017;
- R&D tax credits receipts from HMRC for 2016;
- £0.5m credit line secured on Modern Water Inc's trade receivables;
- favourable movement in the Group's working capital, specifically reduction in inventories and aged trade receivables in the Monitoring Division; and
- first meaningful revenues from the commercialisation of the Membrane division's technology.

In addition Modern Water is pursuing a number of commercial opportunities, which would provide incremental positive cash inflows, the most significant of which is the joint venture between Modern Water and Northumbrian Water.

***2.1.2 Changes in accounting policy and disclosures***

***(a) New and amended standards adopted by the Group***

There are no new standards, amendments or interpretations effective for the financial year beginning on 1 January 2016 which are material to the group.

***(b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2017 and not adopted early***

New standards and amendments to standards and interpretations effective for annual periods beginning after 1 January 2017 have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group.

***IFRS 9 'Financial Instruments'***

The new standard for financial instruments (IFRS 9) introduces extensive changes to IAS 39's guidance on the classification and measurement of financial assets and introduces a new 'expected credit loss' model for the impairment of financial assets. IFRS 9 also provides new guidance on the application of hedge accounting. Management has started to assess the impact of IFRS 9 but is not yet in a position to provide quantified information. At this stage the main areas of expected impact are as follows:

the classification and measurement of the Group's financial assets will need to be reviewed based on the new criteria that considers the assets' contractual cash flows and the business model in which they are managed

an expected credit loss-based impairment will need to be recognised on the Group's trade receivables

IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018.

***IFRS 15 'Revenue from Contracts with Customers'***

IFRS 15 presents new requirements for the recognition of revenue, replacing IAS 18 'Revenue', IAS 11 'Construction Contracts', and several revenue-related Interpretations. The new standard establishes a control-based revenue recognition model and provides additional guidance in many areas not covered in detail under existing IFRSs, including how to account for arrangements with multiple performance obligations, variable pricing, customer refund rights, supplier repurchase options, and other common complexities.

IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018.

*Management intends to adopt the Standard using the modified retrospective option, recognising the cumulative* effect of initially applying this Standard as an adjustment to the opening balance of retained earnings on the initial date of application. Under this method, IFRS 15 will only be applied to contracts that are incomplete as at 1 January 2018.

Management is yet to fully assess the impact of the Standard and therefore is unable to provide quantified information

***IFRS 16 'Leases'***

IFRS 16 will replace IAS 17 and three related Interpretations. It completes the IASB's long-running project to overhaul lease accounting. Leases will be recorded on the statement of financial position in the form of a right-of-use asset and a lease liability. IFRS 16 is effective from periods beginning on or after 1 January 2019. Management is yet to fully assess the impact of the Standard and therefore is unable to provide quantified information. However, in order to determine the impact the Group are in the process of:

performing a full review of all agreements to assess whether any additional contracts will now become a lease under IFRS 16's new definition

deciding which transitional provision to adopt; either full retrospective application or partial retrospective application (which means comparatives do not need to be restated). The partial application method also provides optional relief from reassessing whether contracts in place are, or contain, a lease, as well as other reliefs. Deciding which of these practical expedients to adopt is important as they are one-off choices

assessing their current disclosures for operating leases as these are likely to form the basis of the amounts to be capitalised and become right-of-use assets

determining which optional accounting simplifications apply to their lease portfolio and if they are going to use these exemptions

considering the IT system requirements and whether a new leasing system is needed. This is being considered in line with implementing IFRS 15 and IFRS 9 so the Group only have to undergo one set of system changes.

### *2.1.3 Parent company financial statements*
Modern Water plc has taken advantage of the exemption provided under section 408 of the Companies Act 2006 not to disclose the parent company statement of comprehensive income. The loss attributed to the parent company in the year was £394,000 (2015 loss of: £6,590,000).

### *2.2 Basis of consolidation*
The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries).

#### *(a) Subsidiaries*
Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee
- The ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement(s) with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Acquisition costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is re-measured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39 either in the profit and loss or as a charge to other comprehensive income.

Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred in relation to the fair value of the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in the statement of comprehensive income.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

#### *(b) Transactions with non-controlling interests*
The Group treats transactions with non-controlling interests as transactions with the equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of the net assets of the subsidiary is recorded in equity.

Comprehensive losses are attributable to non-controlling interests only to the extent the Group expects to recover them.

When the Group ceases to have control or significant influence, any retained interest in the entity is re-measured to fair value with the change in carrying amount recognised in the statement of comprehensive income. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. Any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the profit or loss.

***2.3 Segment reporting***

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Board that makes strategic decisions.

***2.4 Foreign currency translation***

***(a) Functional and presentation currency***

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in sterling (£), which is the Group's presentation currency and the Company's functional currency.

***(b) Transactions and balances***

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of comprehensive income within 'finance income or cost'.

***(c) Group companies***

The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income.

***2.5 Property, plant and equipment***

All property, plant and equipment is shown at cost less accumulated depreciation and impairment. Cost includes expenditure that is attributable to the acquisition of the items. Depreciation on assets is calculated using the straight-line method to allocate the cost of each asset to its residual value over its estimated useful economic life, as follows:

| | | |
|---|---|---|
| Leasehold improvements | – | remaining term of the lease |
| Plant and machinery | – | three to five years |
| Motor vehicles | – | three to five years |
| Office equipment | – | three to five years |
| Furniture, fixtures and fittings | – | three to five years |

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

Subsequent costs are capitalised only when it is probable that they will result in future economic benefits flowing to the Group and when they can be measured reliably. All other repairs and maintenance expenditure is charged to the statement of comprehensive income in the period in which it is incurred.

# Notes to the Consolidated Financial Statements (continued)

***2.6 Intangible assets***

***(a) Goodwill***

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/joint venture/associate at the date of acquisition:

- goodwill on acquisitions of subsidiaries is included in 'intangible assets'; and
- goodwill on acquisitions of joint ventures is included in 'investments in joint ventures' and is tested for impairment as part of the overall balance

Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Goodwill is not subject to amortisation, but is tested for impairment annually to identify whether there have been events or a change in circumstances to indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows in Cash Generating Units (CGUs). The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose. Due to the pre-revenue stage of most of the Group's technologies, value in use has been assessed based on the present value of applying the Group's technologies to potential contracts in the future and an assessment of the expected number of such contracts.

***(b) Patents and trademarks***

Separately acquired patents are recognised at historical cost. They have a finite useful economic life and are subsequently carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents over their estimated useful economic lives of 20 years from patent filing.

Trademarks are initially recorded at historical cost. They have a finite useful life and are subsequently carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks over their useful economic life of five years from filing.

***(c) Development costs***

Development costs identified as a result of a business combination are accounted for in accordance with IAS 38, brought on to the consolidated statement of financial position at the date of acquisition and amortised on a straight-line basis between 10 and 20 years.

***(d) Research and development***

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Any internally-generated development costs are recognised as an asset only if all of the following are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably

Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Internally generated intangible assets are amortised on a straight-line basis over three years.

Patented technology acquired as part of a business combination is recorded at the fair value on acquisition and amortised on a straight-line basis over the useful economic life of the asset.

R&D tax credits received are recorded as income in the corporation tax charge/benefit in the year the cash is received.

***2.7 Impairment of intangible assets, investments, property, plant and equipment***

Goodwill has an indefinite useful economic life, is not subject to amortisation and is tested annually for impairment as described in notes 2.6 and 15.

Assets that are subject to amortisation or depreciation are tested for impairment when events or a change in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows . Due to the pre-revenue stage of most of the Group's technologies, value in use has been assessed based on the present value of applying the Group's technologies to potential contracts in the future and an assessment of the expected number of such contracts.

***2.8 Investments***

Investments are stated at cost less any provision for impairment. Investment assets are tested annually for impairment, see note 15.

***2.9 Leases***

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

***2.10 Financial instruments***

Financial assets and liabilities are recognised in the Group's statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

***(a) Cash and cash equivalents***

Cash at bank comprises cash available on demand. Short-term deposits with a maturity from inception of one year or less placed with financial institutions are classified as cash equivalents if they can be converted to cash at any time without significant penalties.

***(b) Trade receivables***

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Specific bad and doubtful debt provisions are established against trade receivables that are greater than six months overdue where management considers that there is a risk that the customer will not settle the receivable balance.

***(c) Trade payables***

Trade payables are not interest bearing and are initially measured at their fair value and subsequently measured at amortised cost.

***2.11 Inventories***

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour and other direct costs but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Provisions, if necessary, are made for slow-moving, obsolete and defective inventories.

***2.12 Share Capital***

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

***2.13 Employee benefits***

***(a) Pension obligations***

The Group has a defined contribution pension plan for directors and staff. The scheme is administered by an insurance company to which the Group pays fixed contributions and the Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

***(b) Share-based payments***

Share-based incentive arrangements are provided to directors and employees. The Group operates a number of share-based payment schemes under the Modern Water plc Incentive Plan (MWIP) which is described in note 9.

The fair value of the services received in exchange for the share-based payment is recognised as an expense with a corresponding credit to equity, where the payment is equity–settled, if cash settled then the cost is accrued in the statement of financial position. Where equity-settled the total amount to be expensed over the vesting period is determined by reference to the fair value of the options and bonus shares granted at the date of grant using either a Black-Scholes or Monte Carlo pricing model. Where cash-settled the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted at the date of grant and then reassessed at each subsequent reporting date using the Black-Scholes model. The annual charge is modified to take account of awards granted to employees who leave the Group during the performance or vesting period and forfeit their rights to the share options and in the case of non-market related performance conditions, where it becomes unlikely they will vest.

The grant by the Company of share-based payments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity.

### *2.14 Taxation*

The current income tax charge is calculated on the basis of the tax laws applicable to the current year and enacted or substantively enacted at the statement of financial position date in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation, and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination, which at the time of the transaction affects neither the accounting nor the taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

### *2.15 Revenue and income recognition*

Revenue comprises the fair value of the consideration received or receivable for the sale of goods, services and royalty income in the ordinary course of the Group's activities. Revenue is shown net of trade and early settlement discounts, value added tax (VAT) and similar sales taxes.

#### *(a) Royalties*

Royalty income is recognised as revenue on an accruals basis in accordance with the substance of the relevant agreements. Royalty income is therefore recognised in the year on the basis of royalty statements provided by distributors.

#### *(b) Provision of goods and services*

Revenue from the provision of goods and services is recognised when the risks and rewards of ownership have been transferred to the customer. The risks and rewards of ownership are deemed to have been transferred when the goods are delivered and the services provided to the customer. Where the customer wishes to delay taking delivery of the goods, agrees to be invoiced for the goods, and the goods are on hand ready for delivery and usual payment terms apply, transfer of the risks and rewards is deemed to occur when the goods are ready to be shipped to the customer. Goods in transit are deemed to be owned by the customer if the customer arranges transit or by the Group if the Group arranges transit. Revenue for services rendered is generally for the installation and servicing of products and the training of customer staff. Revenue for services is recognised once the service has been completed.

#### *(c) Interest*

Income is recognised as interest accrues, using the effective interest method. Interest income is included in finance income in the statement of comprehensive income.

*(d) **Grants***
*Grants are recognised when there is reasonable assurance that the entity will comply with the conditions related* to them and that the grants will be received.

Grants related to income are recognised over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. Grants relating to income are recognised as other income in the statement of comprehensive income. Unutilised grants are held in accruals and deferred income in the Group Statement of Financial Position.

Grants relating to assets are deducted from the carrying value of the asset. The statement of comprehensive income is affected by a reduced depreciation charge over the useful economic life of the asset.

***2.16 Exceptional items***
Exceptional items are disclosed separately in the financial statements where it is necessary to do so to provide further understanding of the financial performance of the group. They are material items of income or expense that have been shown separately due to the significance of their nature or amount.

**3. Financial risk management**

The Group is subject to a number of financial risks, principally market risk (interest rate risk and foreign exchange risk); credit risk; liquidity risk; and capital risk. The Group's policy aims to mitigate these risks though a conservative approach to treasury management:

***(a) Market risk***

***(i) Interest risk***

The Group's interest rate risk arises from variable interest rates on finance income and investing cash flows from the cash deposits. The Group's policy is to invest in fixed interest term deposits, thereby mitigating uncertainty over the future interest receipts. As the Group has no borrowings it only has limited interest rate risk.

***(ii) Foreign exchange risk***

*During 2016 the majority of the Group's costs were in pounds sterling and US dollars therefore it was appropriate* to hold funds in pounds sterling and US dollars. The Group does have a major supplier who invoices in Australian dollars and for these payments the Group maintains an Australian dollar bank account, purchasing Australian dollars when a commitment is certain or when there is a favourable exchange rate. In addition to sterling and US dollar accounts, the Group does maintain Australian dollar and Euro accounts for customer receipts and to hold currency to hedge against future commitments in those currencies.

***(b) Credit risk***

The Group is exposed to credit risk from placing significant deposits with counterparties. The Group's policy is to restrict counterparties to institutions that are Moody's A rated when the deposit is placed; ratings can change during the term of the deposit. Cash balances by counterparty credit rating are listed in note 19. Additionally the Group is exposed to credit risk from customers. This risk is mitigated in the Monitoring Division through new customers being required to pay in advance for their first purchase. Customer's seeking credit undergo a credit application process and are subject to credit limits. Accounts receivable balances are monitored and actively managed on a regular basis.

***(c) Liquidity risk***

The Group's liquidity risk arises from cash being on deposit with counterparties and therefore not available at short notice to meet requirements. The Group's policy is to maintain rolling cash flow forecasts and place cash on deposit with a range of maturity dates to meet forecast liquidity requirements. The maximum duration for a term deposit is 12 months from the date of deposit.

***(d) Capital risk***
Capital risk relates to the long term funding requirements for the Group. The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. At the Group's current stage of development it is appropriate for it to be wholly funded by equity. As the Group develops, this capital structure will be reviewed.

**4. Critical accounting estimates and judgements**

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are addressed below:

***(a) Estimated impairment of goodwill***

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 2.6. The recoverable amounts of cash generating units (CGU) have been determined based on the higher of fair value less costs of disposal and value-in-use calculations. These calculations require the use of estimates. An impairment charge of £nil (2015: £nil) was made to goodwill in 2016. Detail of the impairment tests and the key assumptions is included in note 15.

***(b) Acquired intangible assets***

The Group is carrying significant intangible assets (patented technology and research and development) arising from business combinations in prior years, in accordance with the accounting policy stated in note 2.6. Estimation of the fair values of intangible assets acquired through business combinations requires assumptions as to replacement cost, value, future useful economic life and future cash flows for impairment tests. There is a high degree of judgement required in making these assumptions which impact both the initial fair value acquired and the carrying value as at the balance sheet date.

***(c) Share-based payments***

The fair value calculation of share-based payments requires several assumptions and estimates. Their details are included in note 9. Such assumptions and estimates could change and could affect the amount recorded.

***(d) Going Concern***

The directors have carried out a review of forecast cash flows and have concluded that the going concern basis is justified in preparation of the financial statements. Estimates and assumptions have been used in carrying out this review.

***(e) Deferred tax recognition***

The extent to which deferred tax assets can be recognised is based on an assessment of the probability that future taxable income will be available against which the deductible temporary differences and tax loss carry-forwards can be utilised. In addition, significant judgement is required in assessing the impact of any legal or economic limits or uncertainties in various tax jurisdictions.

***(f) Stock provisions***

Management estimates the net realisable values of inventories, taking into account the most reliable evidence available at each reporting date. The future realisation of these inventories may be affected by future technology or other market-driven changes that may reduce future selling prices.

## 5. Segmental analysis

### *5.1 Reportable segments*

The chief operating decision-maker is deemed to be the Board, for whom monthly financial information is provided by division to gross profit and direct overheads; below this financial information is reported in a consolidated Group format. For management reporting purposes the Group is organised into two operating segments (i) Membranes; and (ii) Monitoring, which matches this divisional split.

Administrative expenses which are directly attributable to the two main operating divisions (comprised of business development, sales, operations and technical expenditure) are reported as expenditure in the respective division. However, a significant proportion of the Group's expenditure (legal, marketing, finance, facilities and directors' expenditure) is managed and reported centrally. As the commercial activities of the Group develop, this financial information is expected to evolve.

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Membrane £000 | Monitoring £000 | Central £000 | Total £000 | Membrane £000 | Monitoring £000 | Central £000 | Total £000 |
| Revenue | **148** | **3,481** | **—** | **3,629** | 10 | 3,222 | — | 3,232 |
| Cost of sales | **(35)** | **(1,729)** | **—** | **(1,764)** | (38) | (1,986) | — | (2,024) |
| Gross profit / (loss) | **113** | **1,752** | **—** | **1,865** | (28) | 1,236 | — | 1,208 |
| Administrative expenses | **(1,313)** | **(1,692)** | **(1,302)** | **(4,307)** | (1,607) | (1,744) | (1,529) | (4,880) |
| Share based payments | **—** | **—** | **(107)** | **(107)** | — | — | (56) | (56) |
| Other gains - net | **—** | **—** | **—** | **—** | — | — | 18 | 18 |
| Operating profit /(loss) before depreciation and amortisation | **(1,200)** | **60** | **(1,409)** | **(2,549)** | (1,635) | (508) | (1,567) | (3,710) |
| Depreciation and amortisation | **(69)** | **(432)** | **(1)** | **(502)** | (60) | (445) | (22) | (527) |
| Operating profit / (loss) | **(1,269)** | **(372)** | **(1,410)** | **(3,051)** | (1,695) | (953) | (1,589) | (4,237) |
| Finance income | **—** | **—** | **514** | **514** | — | — | 210 | 210 |
| Finance costs | **—** | **—** | **(30)** | **(30)** | — | — | — | — |
| Profit / (loss) before taxation | **(1,269)** | **(372)** | **(926)** | **(2,567)** | (1,695) | (953) | (1,379) | (4,027) |
| Taxation | **318** | **134** | **13** | **465** | 93 | — | 156 | 249 |
| Profit / (loss) for the year | **(951)** | **(238)** | **(913)** | **(2,102)** | (1,602) | (953) | (1,223) | (3,778) |

2015 figures have been restated to give better disclosure of divisional financials

The Monitoring division recognised £3,481,000 (2015: £3,222,000) from sale of goods and services and £nil (2015: £nil) revenue from royalties. The Membrane division recognised £148,000 (2014: £10,000) from the sale of water and operating and maintenance contracts and £nil (2015: £nil) from the sale of desalination equipment.

### *5.2 Geographical information*

The Group operates in four main geographical regions, based on customer location.

| | *2016* | | | *2015* | | |
|---|---|---|---|---|---|---|
| Revenue | **Membranes £000** | **Monitoring £000** | **Total £000** | Membranes £000 | Monitoring £000 | Total £000 |
| Americas | **—** | **1,296** | **1,296** | — | 1,178 | 1,178 |
| Europe | **—** | **733** | **733** | — | 725 | 725 |
| Middle East and Africa | **148** | **155** | **303** | 10 | 383 | 393 |
| Asia Pacific | **—** | **1,297** | **1,297** | — | 936 | 936 |
| Total | **148** | **3,481** | **3,629** | 10 | 3,222 | 3,232 |

## Notes to the Consolidated Financial Statements (continued)

The Group has non-current assets in four countries (2015: four), based on location of the assets.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | **Property, plant and equipment £000** | **Intangible assets including goodwill £000** | **Total £000** | Property, plant and equipment £000 | Intangible assets including goodwill £000 | Total £000 |
| UK | **16** | **3,388** | **3,404** | 85 | 3,647 | 3,732 |
| US | **236** | **—** | **236** | 245 | — | 245 |
| Oman | **—** | **—** | **—** | — | — | — |
| Gibraltar | **3** | **—** | **3** | 9 | — | 9 |
| Total | **255** | **3,388** | **3,643** | 339 | 3,647 | 3,986 |

Assets and liabilities are presented to the chief operating decision maker in a consolidated Group format. Assets and liabilities are not currently presented by segment, because they are managed centrally. As the commercial activities of the Group develop, this financial information is expected to evolve.

### *5.3 Major customers*

Within the Monitoring division revenue to one customer totalled £603,000 (2015: £497,000), representing 17% (2015: 15%) of the division's revenue. No other customer represented more than 10% of the division's revenue. All revenue in the Membrane division came from a single customer (2015: 100%).

### 6. Other gains - net

| | **2016 £000** | 2015 £000 |
|---|---|---|
| Grant income | **—** | **18** |
| Total | **—** | **18** |

The 2015 grant income relates to work performed on European Union (EU) funded electro-coagulation projects.

### 7. Administrative expenses by nature

| | Note | **2016 £000** | 2015 £000 |
|---|---|---|---|
| Employee benefits expense | | **2,495** | 2,573 |
| Share-based payments | 9 | **107** | 56 |
| Operating lease payments | 22.1 | **381** | 417 |
| Research and development | | **200** | 156 |
| Auditor's remuneration | 10 | **64** | 103 |
| Other administrative expenses | | **1,167** | 1,631 |
| Total administrative expenses before depreciation, amortisation and exceptional charges | | **4,414** | 4,936 |
| Depreciation and amortisation charges | 14,15 | **502** | 527 |
| Total administrative expenses including depreciation, amortisation and exceptional charges | | **4,916** | 5,463 |

### 8. Employee benefits expense

| | | 2016 | | 2015 | |
|---|---|---|---|---|---|
| | | **Group** | **Company** | Group | Company |
| | Note | **£000** | **£000** | £000 | £000 |
| Staff costs for the year*, including the executive director, amounted to: | | | | | |
| Wages and salaries | | **2,150** | **203** | 2,472 | 195 |
| Social security costs | | **224** | **19** | 210 | 24 |
| Other pension costs | | **92** | **14** | 99 | 14 |
| Other benefits and staff costs | | **219** | **34** | 149 | 13 |
| Total employee benefits expense | | **2,685** | **270** | 2,930 | 246 |
| Equity-settled share-based payments | 9 | **107** | **5** | 56 | (65) |
| | | **2,792** | **275** | 2,986 | 181 |

* 2015 has been restated to include £286,000 of staff costs that were expensed in Cost of sales.

Other benefits include recruitment fees, private health insurance, life insurance and income protection and redundancy costs.

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | **Group** | **Company** | Group | Company |
| | **Number** | **Number** | Number | Number |
| Monthly average number of employees by activity: | | | | |
| Executive director | **1** | **1** | 1 | 1 |
| Technical | **24** | **—** | 25 | — |
| Business development | **13** | **—** | 16 | — |
| Finance, legal and administration | **6** | **—** | 7 | — |
| Total | **44** | **1** | 49 | 1 |

Key management personnel is considered to be the executive director.

The aggregate amount of emoluments, excluding employers pension contributions, paid to the executive director in respect of qualifying services was £142,000 (2015: £142,000). The highest paid director received £142,000 (2015: £142,000), excluding pension contributions. There were no gains made by directors on the exercise of share options (2015: £nil). No money was received by directors under long term incentive schemes (2015: £nil). The executive director in total received £nil in cash bonuses relating to 2016 performance (2015: £nil). The highest paid director received no cash bonus relating to 2015 performance (2014: £nil). The Group paid £14,000 (2015: £14,000) to the executive director in respect of money purchase pension schemes, with the highest paid director receiving £14,000 (2015: £14,000). Total remuneration for non-executive directors was £60,000 (2015: £97,000). See the remuneration table in the Directors' Remuneration Report on page 10 for further details.

In addition to the above costs for permanent staff, the Group utilises the services of contract and agency staff as circumstances require.

### 9. Share-based payment plans

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Group | Company | Group | Company |
| | £000 | £000 | £000 | £000 |
| Options (including EMI) | **107** | **5** | 36 | (71) |
| Conditional share awards | — | — | 20 | 6 |
| Equity-settled share-based payments | **107** | **5** | 56 | (65) |
| Total share-based payments charged to the income *statement* | **107** | 5 | 56 | (65) |
| Equity-settled share-based payments | **107** | 5 | 56 | (65) |
| Capital contribution relating to share-based payments | — | 102 | — | 121 |
| Total share-based payments changes in equity | **107** | **107** | 56 | 56 |

The share-based payment plans are described below. The number of shares issued under these plans is limited to 10% of the issued ordinary share capital of the company.

The Group incurred a £107,000 (2015: £56,000) share-based payment charge of which a charge of £5,000 (2015: £65,000 release) was recognised in the Company's Statement of Comprehensive Income for its employees and a further £102,000 (2015: £121,000) to the employees of subsidiary undertakings. The 2015 credit results from a review of non-market vesting criteria. The charge for equity-settled share-based payments to the employees of the Company's subsidiaries of £102,000 (2015: £121,000) is recognised as a capital contribution in the Company balance sheet (note 16).

***Modern Water plc Incentive Plan (MWIP)***

The MWIP was adopted on 1 June 2007 and contains provisions relating to the making of awards in the form of options and conditional awards of ordinary shares (to be received once performance conditions are satisfied).

***(a) Options (Excluding EMI options)***

Under this scheme share options are granted to management. Certain awards are granted with an exercise price equal to the market price on the date of the grant, others at nil exercise price. The options may be exercised after three years from date of grant. Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest.

The movement in the number of share options is set out below:

| | 2016 | 2015 |
|---|---|---|
| At 1 January | **1,900,877** | 1,815,877 |
| Granted during year | **595,000** | 465,000 |
| Forfeited | **(385,000)** | (380,000) |
| At 31 December | **2,110,877** | 1,900,877 |

The fair value of the equity-settled share options granted is estimated as at the date of grant using a Black-Scholes model, taking into account the terms and conditions upon which the options were granted.

| *Grant date* | 28 April 2016 | 13 March 2015 |
|---|---|---|
| Share price at date of award | 6.63p | 17.13p |
| Number of shares options granted | 595,000 | 465,000 |
| Exercise price | £nil | £nil |
| Assumed volatility at date of award (median of historical 50 day average) | 23% | 23% |
| Vesting period (years) | 3.0 | 3.0 |
| Expected dividend yield | 0% | 0% |
| Risk-free discount rate | 1.0% | 1.0% |
| Fair value per share awarded | 6.63p | 17.13p |

## Notes to the Consolidated Financial Statements (continued)

The weighted average remaining contractual life for the share options outstanding at 31 December 2016 is six years and one month (2015: six years and six months). The weighted average exercise price for options outstanding at the end of the year was 43p (2015: 51p). 560,877 options were exercisable as at 31 December 2016 (2015: 560,877).

***(b) Conditional share awards***

The conditional share awards are provisional awards of ordinary shares in Modern Water plc, which vest three years after the date of the award to the extent that performance conditions have been met. The extent to which the award will vest depends on the Group's share price on the vesting date. If vesting criteria is not met the awards lapse. Awards expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest. The movement in the number of conditional shares awarded is set out below:

| | **2016** | 2015 |
|---|---|---|
| At 1 January | **38,970** | 788,970 |
| Lapsed | **(38,970)** | (750,000) |
| At 31 December | — | 38,970 |

***(c) Enterprise Management Incentives (EMI) options***

Under this scheme share options are granted at nil exercise price to senior management. The options may be exercised after three years to the extent that certain market and non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse. Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest. The movement in the number of EMI options is set out below:

| | 2016 | 2015 |
|---|---|---|
| At 1 January | 2,667,060 | 1,997,060 |
| Granted | 1,190,000 | 1,040,000 |
| Forfeited | (150,000) | (370,000) |
| Lapsed | (1,384,560) | — |
| At 31 December | 2,322,500 | 2,667,060 |

The fair value of the award is estimated as at the date of award using Monte Carlo (where there are market conditions) and Black-Scholes models (where there are no market conditions), taking into account the terms and conditions upon which the shares were awarded. The weighted average fair value of EMI options granted during the year was 6.63p (2015: 17.13p). Inputs into the model used for the options granted in the year are below:

| Grant date | 28 April 2016 | 13 March 2015 |
|---|---|---|
| Share price at date of award | 6.63p | 17.13p |
| Number of options | 1,190,000 | 1,040,000 |
| Exercise price | £nil | £nil |
| Assumed volatility at date of award (median of historical 50 day average) | 23% | 23% |
| Vesting period (years) | 3.0 | 3.0 |
| Expected dividend yield | 0% | 0% |
| Risk-free discount rate | 1.0% | 1.0% |
| Weighted average fair value per share awarded | 6.63p | 17.13p |

# Notes to the Consolidated Financial Statements (continued)

***(d) Cash-settled options***

Under this scheme the Company grants employees the right to receive a cash award, subject to the fulfilment of certain vesting conditions, equal to the vesting date market value of the notional shares awarded to the employees.

The options may be exercised after three years to the extent that certain non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse. Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest.

| | 2016 | 2015 |
|---|---|---|
| At 1 January | 100,000 | 200,000 |
| Forfeited | — | (100,000) |
| Lapsed | (100,000) | — |
| At 31 December | — | 100,000 |

The fair value of the award is estimated as at the date of award using a Black-Scholes model, taking into account the terms and conditions upon which the shares were awarded. The weighted average fair value of cash-settled options granted during the year was £nil (2015: £nil).

## 10. Auditor's remuneration

| | **2016** | 2015 |
|---|---|---|
| | **£000** | £000 |
| Audit of Company and consolidated financial statements | **45** | 72 |
| Audit of subsidiaries | — | 3 |
| Total audit | **45** | 75 |
| | | |
| Tax compliance services | **19** | 28 |
| Total non audit services | **19** | 28 |
| | | |
| Total fees | **64** | 103 |

# Notes to the Consolidated Financial Statements (continued)

**11. Finance income and costs**

| | 2016 £000 | 2015 £000 |
|---|---|---|
| Finance income: | | |
| Bank interest receivable | **4** | 20 |
| Foreign Exchange Gains / (Losses) | **510** | 190 |
| Total finance income | **514** | 210 |
| Finance costs: | | |
| Bank and currency charges | **(30)** | - |
| Total finance costs | **(30)** | - |
| Net finance income | **484** | 210 |

**12. Taxation**

***12.1 Tax on loss on ordinary activities***

| | 2016 £000 | 2015 £000 |
|---|---|---|
| Current tax: | | |
| Tax in respect of R&D activities | **(452)** | (93) |
| Total current tax | **(452)** | (93) |
| | | |
| Deferred tax | | |
| Origination and reversal of temporary differences | **(9)** | (153) |
| Impact of change in the UK tax rate | **(4)** | (3) |
| Total deferred tax | **(13)** | (156) |
| Total tax benefit | **(465)** | (249) |

***12.2 Reconciliation of the total tax charge***

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to losses of the consolidated entities as follows:

| | 2016 £000 | 2015 £000 |
|---|---|---|
| *Loss on ordinary activities before taxation* | **2,553** | **4,027** |
| Loss multiplied by the weighted average tax rate of 20% (2015: 20.25%) | **511** | **815** |
| Expenses not deductible for tax purposes | **(23)** | **(507)** |
| Capital allowances and other timing differences | **(17)** | **(31)** |
| Adjustments in respect of prior years | **9** | **153** |
| Re-measurement of deferred tax – changes in UK tax rate | **4** | **3** |
| Tax in respect of R&D activities | **452** | **93** |
| Losses not utilised | **(471)** | **(277)** |
| Tax credit | **465** | **249** |

### *12.3 Deferred tax liabilities*

| Intangible assets in business combinations | 2016 £000 | 2015 £000 |
|---|---|---|
| At 1 January | **42** | 198 |
| Credited to the statement of comprehensive income | **(13)** | (156) |
| **At 31 December** | **29** | 42 |

The deferred tax liability arises from taxable temporary differences on intangible assets recognised on business combinations and is expected to unwind over the useful economic life of these assets. The analysis of deferred tax liabilities is as follows:

| | 2016 £000 | 2015 £000 |
|---|---|---|
| To be recovered after more than 12 months | **24** | 35 |
| To be recovered within 12 months | **5** | 7 |
| **Deferred tax liabilities** | **29** | 42 |

Deferred tax assets of £5,189,000 at 31 December 2016 (31 December 2015: £5,354,000) in respect of unutilised trading losses have not been recognised, as utilisation is not yet sufficiently certain. No deferred tax assets relating to short term timing differences or depreciation in excess of capital allowances have been recognised, due to uncertainty over the timing of the recovery of these assets.

## 13. Earnings per share

### *13.1 Basic*

Basic earnings / (loss) per share is calculated by dividing the income / (loss) attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

| | 2016 | 2015 |
|---|---|---|
| Income / (Loss) attributable to owners of the parent (£'000) | **(2,102)** | (3,778) |
| Weighted average number of ordinary shares in issue (thousands) | **79,505** | 79,505 |
| **Basic earnings / (loss) per share** | **(2.64p)** | (4.75p) |

### *13.2 Diluted*

As the Group is loss making, the diluted loss per share is equal to the basic loss per share.

# Notes to the Consolidated Financial Statements (continued)

### 14. Property, plant and equipment

| Group | Leasehold improvements £000 | Plant and machinery £000 | Motor vehicles £000 | Office equipment £000 | Furniture, fixtures and fittings £000 | Total £000 |
|---|---|---|---|---|---|---|
| **At 1 January 2015** | | | | | | |
| Cost | 408 | 1,468 | 46 | 403 | 208 | 2,533 |
| Accumulated depreciation | (258) | (1,287) | (42) | (323) | (179) | (2,089) |
| Net book amount | 150 | 181 | 4 | 80 | 29 | 444 |
| **Year ended 31 December 2015** | | | | | | |
| Opening net book amount | 150 | 181 | 4 | 80 | 29 | 444 |
| Exchange differences | 6 | 6 | — | 2 | — | 14 |
| Additions | — | 99 | — | 10 | — | 109 |
| Depreciation charge | (61) | (98) | (3) | (47) | (19) | (228) |
| Closing net book amount | **95** | **188** | **1** | **45** | **10** | **339** |
| **At 31 December 2015** | | | | | | |
| Cost | 422 | 1,580 | 46 | 409 | 206 | 2,663 |
| Accumulated depreciation | (327) | (1,392) | (45) | (364) | (196) | (2,324) |
| Net book amount | **95** | **188** | **1** | **45** | **10** | **339** |
| **Year ended 31 December 2016** | | | | | | |
| Opening net book amount | 95 | 188 | 1 | 45 | 10 | 339 |
| Exchange differences | 14 | 27 | — | 3 | 1 | 45 |
| Additions | — | 70 | — | — | — | 70 |
| Depreciation charge | (57) | (98) | (1) | (36) | (7) | (199) |
| **Closing net book amount** | **52** | **187** | **—** | **12** | **4** | **255** |
| **At 31 December 2016** | | | | | | |
| Cost | 473 | 1,712 | 38 | 429 | 210 | 2,862 |
| Accumulated depreciation | (421) | (1,525) | (38) | (417) | (206) | (2,607) |
| **Net book amount** | **52** | **187** | **—** | **12** | **4** | **255** |

There were no property, plant and equipment assets recognised in the Company's Statement of Financial Position as at 31 December 2016 (2015: none).

## 15. Intangible assets

| Group | Goodwill £000 | Patent and trademark costs £000 | Development costs £000 | Research and development, and patented technology acquired as part of a business combination £000 | Customer contracts acquired as part of a business combination £000 | Total £000 |
|---|---|---|---|---|---|---|
| **At 1 January 2015** | | | | | | |
| Cost | 13,434 | 923 | 131 | 4,007 | 180 | 18,675 |
| Accumulated amortisation and impairment charge | (11,902) | (380) | (131) | (2,190) | (180) | (14,783) |
| Net book amount | **1,532** | **543** | — | **1,817** | — | **3,892** |
| Year ended 31 December 2015 | | | | | | |
| Opening net book amount | 1,532 | 543 | — | 1,817 | — | 3,892 |
| Additions | — | 54 | — | — | — | 54 |
| Amortisation charge | — | (44) | — | (255) | — | (299) |
| **Closing net book amount** | **1,532** | **553** | — | **1,562** | — | **3,647** |
| **At 31 December 2015** | | | | | | |
| Cost | 13,434 | 977 | 131 | 4,007 | 180 | 18,729 |
| Accumulated amortisation and impairment charge | (11,902) | (424) | (131) | (2,445) | (180) | (15,082) |
| **Net book amount** | **1,532** | **553** | — | **1,562** | — | **3,647** |
| **Year ended 31 December 2016** | | | | | | |
| Opening net book amount | 1,532 | 553 | — | 1,562 | — | 3,647 |
| Additions | — | 44 | — | — | — | 44 |
| Amortisation charge | — | (48) | — | (255) | — | (303) |
| **Closing net book amount** | **1,532** | **549** | — | **1,307** | — | **3,388** |
| **At 31 December 2016** | | | | | | |
| Cost | 13,434 | 1,021 | 131 | 4,007 | 180 | 18,773 |
| Accumulated amortisation and impairment charge | (11,902) | (472) | (131) | (2,700) | (180) | (15,385) |
| **Net book amount** | **1,532** | **549** | — | **1,307** | — | **3,388** |

Additions to patent costs arise from legal and other fees incurred in securing patents. These are valued at the actual costs related to prosecuting the patents.

The goodwill carrying value by cash generating unit (CGU) is summarised below:

| Group | **2016 £000** | 2015 £000 |
|---|---|---|
| Poseidon Water Limited | **140** | 140 |
| Cymtox Limited | **629** | 629 |
| Modern Water Monitoring Limited (previously Cogent Environmental Limited) | **663** | 663 |
| AguaCure Ltd | **100** | 100 |
| Total Group goodwill | **1,532** | 1,532 |

Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

No impairment charge was made in 2016 (2015: £nil).

The goodwill impairment review indicated that the recoverable amounts for all CGUs are in excess of the carrying value and that there is sufficient headroom for management to believe that no reasonable change in any of its assumptions would reduce forecasts enough to cause the carrying values to exceed the recoverable amounts. Therefore no further goodwill impairment was recorded in the year.

The recoverable amounts are determined using the higher of the CGU fair value less costs of disposal (FV) and value in use (VIU) calculations. The fair value less costs of disposal method calculates the fair value of each CGU based on the Company's share price and the selling prices of comparable businesses. The VIU method requires the estimation of future cash flows before tax and the selection of a suitable discount rate in order to calculate the net present value (NPV) of these cash flows. The discount rates applied to each CGU for the value in use projections are between 15% and 20% as outlined below (2015: 15% and 20%) and all assumptions were reviewed at the end of the year and revised where necessary. No need for impairment was noted under these scenarios.

The key assumptions for the Monitoring division (including Cymtox Ltd and Modern Water Monitoring Ltd) value in use calculations are sales volume and gross margin. Management's forecasts are based on the current five year business plan and assume the division delivers double digit revenue growth. A discount rate of 15% and a terminal growth rate of 2% are used to calculate the NPV and this is stress tested by reducing revenue growth by 10% and removing the terminal value entirely.

The key assumption for Membrane division (including Poseidon Water Limited and Aguacure Ltd), value in use calculations is the securing of wastewater contracts over the next five years. Again, management's forecasts are based on the current five year business plan, which anticipates significant new contract wins for this division The early stage of adoption of some of Modern Water's technology means that there remains a significant level of judgement involved in making these sales assumptions. A discount rate of 20% and a terminal growth rate of 2% are used to calculate the PV and this is stress tested by halving the forecast revenue and removing the terminal value entirely.

There were no intangible assets recognised in the Company's Statement of Financial Position as at 31 December 2016 (2015: none).

### 16. Investments

| Company | Investment in subsidiary £000 |
|---|---|
| **Year ended 31 December 2015** | |
| Opening book amount | 2,697 |
| Capital contribution relating to share-based payments | 121 |
| Impairment charge | (1,190) |
| **Closing book amount** | **1,628** |
| **Year ended 31 December 2016** | |
| Opening book amount | 1,628 |
| Capital contribution relating to share-based payments | 102 |
| Impairment charge | - |
| **Closing book amount** | **1,730** |

The impairment charge in 2015 is for the investment which the Company has in Modern Water Services Limited, for consistency with the impairment of the Surrey Aquatechnology Limited investment.

# Notes to the Consolidated Financial Statements (continued)

| **Subsidiary undertakings** *which contribute to the group result* | Principal activities | % Shareholding | Status |
|---|---|---|---|
| Modern Water Services Limited | Technical, business development, finance, legal and admin services to the Group companies | 100 | Subsidiary |
| Surrey Aquatechnology Limited | Desalination technology | 100 | Subsidiary |
| Modern Water Holdings Limited | Holding company for water treatment operating companies and investments | 100 | Subsidiary |
| Modern Water Technology (Shanghai) Co., Ltd | Project and operating company in China | 100 | Subsidiary |
| Modern Water Technologies LLC | Project and operating company in Oman | 70 | Subsidiary |
| MW Monitoring Limited | Holding company for monitoring instrumentation business | 100 | Subsidiary |
| Modern Water Inc | Toxicity and environmental monitoring products | 100 | Subsidiary |
| MW Monitoring IP Limited | Owners of IP for toxicity and environmental monitoring products | 100 | Subsidiary |
| Modern Water Monitoring Limited | Water and soil monitoring products | 100 | Subsidiary |
| Cymtox Limited | Toxicity monitoring applications | 100 | Subsidiary |
| Aguacure Ltd | Electro-coagulation wastewater treatment systems | 100 | Subsidiary |
| Poseidon Water Limited | Saline wastewater treatment systems | 51 | Subsidiary |
| Modern Water (Nominees) Limited | Acquisition and allocation of shares for the Group | 100 | Subsidiary |

Modern Water Inc is a Delaware corporation. Modern Water Technologies LLC is a company registered in Oman. Modern Water Technology (Shanghai) Co., Ltd is a company registered in China. All other subsidiaries are incorporated in England and Wales. Shares held are all ordinary share capital. The Group had no investments in the current or prior year.

### 17. Inventories

| | Group | | Company | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | 2015 |
| | **£000** | **£000** | **£000** | £000 |
| Raw materials | **351** | **333** | — | — |
| Work in progress | **83** | **29** | — | — |
| Finished goods | **885** | **1,097** | — | — |
| Total inventories | **1,319** | **1,459** | — | — |

The cost of inventories recognised as expense and included in 'cost of sales' amounted to £1,444,000 (2015: £1,475,000). The carrying value of inventories is net of a £138,000 provision for slow moving and obsolete inventories (2015: £245,000).

### 18. Trade and other receivables

| | Group | | Company | |
|---|---|---|---|---|
| | **2016** | 2015 | **2016** | 2015 |
| | **£000** | £000 | **£000** | £000 |
| Trade receivables | **1,109** | 568 | — | — |
| Provision | **(12)** | (45) | — | — |
| Trade receivables – net | **1,097** | 523 | — | — |
| Value added tax | **41** | 73 | **15** | 12 |
| Other receivables | **120** | 49 | — | — |
| Amounts due from subsidiary undertakings | — | — | **5,543** | 4,127 |
| Amounts due from non-controlling interests | **159** | 126 | — | — |
| Prepayments | **142** | 275 | **9** | 2 |
| Total trade and other receivables | **1,559** | 1,046 | **5,567** | 4,141 |

*Accrued income includes interest due on term deposits.* The amounts due from subsidiary undertakings are unsecured, bear no interest and are repayable on demand.

# Notes to the Consolidated Financial Statements (continued)

As at 31 December Group trade receivables of £273,000 (2015: £187,000) were past due, of which £12,000 was provided against (2015: £45,000). The ageing of these receivables is as follows:

| | Group | |
|---|---|---|
| | 2016 | 2015 |
| | £000 | £000 |
| Up to 3 months past due date | 220 | 62 |
| 3 to 6 months past due date | 14 | 43 |
| More than 6 months past due date | 39 | 82 |
| Trade receivables past due date | 273 | 187 |
| Trade receivables not yet due and not considered impaired | 836 | 381 |
| Total trade receivables | 1,109 | 568 |

The carrying amounts of the Group's trade receivables are denominated in the following currencies:

| | Group | |
|---|---|---|
| | 2016 | 2015 |
| | £000 | £000 |
| UK pound sterling | 215 | 101 |
| US dollar | 884 | 438 |
| Omani rial | — | 25 |
| Euro | 10 | 4 |
| | 1,109 | 568 |

The Company has no trade receivables

Movements on the Group's provision for impairment of trade receivables are as follows:

| | Group | |
|---|---|---|
| | 2016 | 2015 |
| | £000 | £000 |
| At 1 January | 45 | 44 |
| Provision for receivables impairment | (33) | 1 |
| | 12 | 45 |

The Company had no trade and other receivables past due but not impaired (2015: £nil). The directors believe that the carrying value of the Company's receivables from subsidiary undertakings is supported by their expected future cash flows.

## 19. Cash

### *19.1 Cash and cash equivalents*

| | Group | | Company | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Cash and cash equivalents | £000 | £000 | £000 | £000 |
| Cash at bank | 1,072 | 3,161 | 419 | 2,218 |
| Cash at bank and in hand | 1,072 | 3,161 | 419 | 2,218 |

### *19.2 Credit quality of cash and cash equivalents*

| | | Group | | Company | |
|---|---|---|---|---|---|
| | | 2016 | 2015 | 2016 | 2015 |
| Short term | Long term | £000 | £000 | £000 | £000 |
| P-1 | AA | 793 | 3,052 | 419 | 2,206 |
| P-1 | A | 279 | 97 | — | — |
| P-2 | Baa | — | 12 | — | 12 |
| Cash at bank and in hand | | 1,072 | 3,161 | 419 | 2,218 |

The credit quality of the cash and cash equivalents is assessed using Moody's short and long term ratings.

### 20. Trade and other payables

| | Group | | Company | |
|---|---|---|---|---|
| | **2016** | 2015 | **2016** | 2015 |
| **Current** | **£000** | £000 | **£000** | £000 |
| Trade payables | **213** | 136 | **63** | 16 |
| Social security | **50** | 47 | **6** | 8 |
| Accruals and deferred income | **390** | 445 | **27** | 56 |
| Total trade and other payables | **653** | 628 | **96** | 80 |

### 21. Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below. The fair value of the assets and liabilities is equal to their carrying value.

| | **2016** | 2015 |
|---|---|---|
| **Group** | **Loans and receivables** | Loans and receivables |
| | **£000** | £000 |
| **Assets as per statement of financial position** | | |
| Trade and other receivables* | **1,376** | 698 |
| Cash and cash equivalents | **1,072** | 3,161 |
| **Total** | **2,448** | 3,859 |
| | **Financial liabilities *amortised at cost*** | Financial liabilities *amortised at cost* |
| | **£000** | £000 |
| **Liabilities as per statement of financial position** | | |
| Trade and other payables** | **603** | 581 |
| **Total** | **603** | 581 |

| | **2016** | 2015 |
|---|---|---|
| **Company** | **Loans and receivables** | Loans and receivables |
| | **£000** | £000 |
| **Assets as per statement of financial position** | | |
| Trade and other receivables* | **5,543** | 4,139 |
| Cash and cash equivalents | **419** | 2,218 |
| **Total** | **5,962** | 6,357 |
| | **Financial liabilities *amortised at cost*** | Financial liabilities *amortised at cost* |
| | **£000** | £000 |
| **Liabilities as per statement of financial position** | | |
| Trade and other payables** | **90** | 72 |
| **Total** | **90** | 72 |

* excludes prepayments and VAT

** includes accruals, but excludes social security

Included in the cash and cash equivalents of the Group and Company at 31 December 2016 was the equivalent of £360,000 (2015: £468,000) denominated in US dollars, £100,000 (2015: £203,000) denominated in Euros, £20,000 in Omani Rials (2015: £16,000), £nil in Australian dollars (2015: £39,000) and £14,000 in Chinese Yuan (2015: £10,000). The balance was denominated in pounds sterling (£). See note 18 for denomination of trade receivables by currency.

## 22. Commitments and contingencies

### *22.1 Group operating leases*

Future aggregate minimum lease payments under non-cancellable operating leases as at 31 December are as follows:

| | Group | |
|---|---|---|
| | **2016** | 2015 |
| | **£000** | £000 |
| Not later than one year | **144** | 305 |
| After one year but not more than five years | **86** | 243 |
| Group operating leases | **230** | 548 |

The Group's operating leases relate to property and office equipment, and have remaining terms up to five years. The amount recognised as an expense in the year is £381,000 (2015: £417,000). The Company does not have any operating lease commitments (2015: none).

### *22.2 Contingent liabilities*

Neither the Group nor the Company had any contingent liabilities at the balance sheet date (2015: £nil).

## 23. Share capital and premium

| Group and Company | Authorised ordinary shares of 0.25p each Number | Allotted and fully paid ordinary shares Number | Authorised ordinary shares £000 | Allotted and fully paid ordinary shares £000 | Share premium £000 | Total £000 |
|---|---|---|---|---|---|---|
| **At 1 January 2015** | 100,000,000 | 79,505,256 | 250 | 199 | 40,032 | 40,231 |
| **At 31 December 2015** | 100,000,000 | 79,505,256 | 250 | 199 | 40,032 | 40,231 |
| **At 31 December 2016** | **100,000,000** | **79,505,256** | **250** | **199** | **40,032** | **40,231** |

On 12 February 2013, the Company announced the conditional placing of 20,000,000 new shares of 0.25p each. The shares were admitted to trading in two tranches, on 1 March 2013 and 4 March 2013.

## 24. Net cash flows used in operating activities

| | | Group | | Company | |
|---|---|---|---|---|---|
| | | **2016** | 2015 | **2016** | 2015 |
| | Note | **£000** | £000 | **£000** | £000 |
| Loss on ordinary activities before taxation | | **(2,567)** | (4,027) | **(394)** | (6,590) |
| **Adjustments for:** | | | | | |
| Depreciation of property, plant and equipment | 14 | **199** | 228 | — | — |
| Amortisation of intangible assets | 15 | **303** | 299 | — | — |
| Goodwill, intangibles and investment impairment | 15,16 | — | — | — | 1,190 |
| Net finance income | 11 | **(484)** | (210) | **(10)** | (27) |
| Share-based payments | 9 | **107** | 56 | **5** | (65) |
| R&D Tax credit receipts | | **452** | 93 | — | — |
| **Movements in working capital:** | | | | | |
| (Increase) / decrease in inventories | 17 | **296** | 27 | — | — |
| Decrease / (increase) in trade and other receivables | 18 | **(384)** | 811 | **(1,426)** | 2,179 |
| Increase / (decrease) in trade and other payables | 20 | **104** | (764) | **16** | (162) |
| **Cash used in operations** | | **(1,974)** | (3,487) | **(1,809)** | (3,475) |

**25. Related party transactions**
IP Group plc held 20.0% of the ordinary share capital of the Company as at 31 December 2016 and appoints a non-executive director, and it is therefore deemed a related party. A service agreement dated 1 December 2006 was made between the Company and IP Group plc, whereby IP Group plc provides strategic, business development and administrative services to the Company. Fees for the year were £30,000 (2015: £40,000) and as at 31 December 2016 £7,500 (2015: £7,500) was outstanding under this agreement.

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation in the Group accounts, but require disclosure in the Company accounts.

The Company had receivable balances at 31 December 2016 with its subsidiary companies to fund working capital and acquisition of investments. No interest is charged on these balances, which are as follows:

- Modern Water Services Limited – £23.4m (2015: £22.0m). A provision of £22.0m is held against this balance.
- Surrey Aquatechnology Limited – £1.4m (2015: £1.3m). A provision of £1.3m is held against this balance.
- *MW Monitoring Limited - £5m (2015: £5m). A provision of £2.5m is held against this balance.*
- Modern Water Monitoring Limited – £3.0m (2015: £3.0m). A provision of £3.0m is held against this balance.
- Cymtox Limited – £709,000 (2015: £740,000);
- AguaCure Ltd – £188,000 (2015: £185,000);
- Poseidon Water Limited – £186,000 (2015: £178,000);
- Modern Water Holdings Limited – £487,000 (2015: £516,000).

# ADVISERS

**Registered office**
Bramley House
The Guildway
Old Portsmouth Road
Guildford
Surrey
GU3 1LR

**Company number**
Registered in England and Wales, number 05963927

Further details can be found on the Modern Water website: ***www.modernwater.com***

**Directors & Company Secretary**
Alan Wilson (Non-executive Chairman)
Simon Humphrey (Chief Executive Officer)
Mike Townend (Non-executive Director)
Toby Schumacher (General Counsel & Company Secretary)

**Nominated adviser and broker**
WH Ireland Limited
24 Martin Lane
London
EC4R 0DR

**Independent auditor**
Grant Thornton UK LLP
Grant Thornton House
Melton Street
Euston Square
London
NW1 2EP

**Registrars**
***Capita Asset Services***
The Registry
34 Beckenham Road
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**Principal bankers**
***HSBC Bank plc***
HSBC House
Mitchell Way
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SO18 2XU