Compound Photonics Group Limited

Annual Report and Consolidated Financial Statements

Year Ended

31 December 2014

Company Number 06917133

Compound Photonics Group Limited

Report and financial statements
for the year ended 31 December 2014

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Directors

B G Bolger
A P A De Cort
M D Faulkner
J P A Fletcher
R C Lind
J A Sachs

Registered office

Millennium Way, Heighington Lane Business Park, Newton Aycliffe, County Durham, DL5 6JW

Company number

06917133

Auditors

BDO LLP, 2 City Place, Beehive Ring Road, Gatwick, West Sussex, RH6 0PA

Compound Photonics Group Limited

Strategic report
for the year ended 31 December 2014

PRINCIPAL ACTIVITIES

Research and development

The Group is engaged in research and development on:

- lasers;
- optics;
- opto/electronics, and
- projection light engines.

The Compound Photonics Group Limited and its subsidiaries (the "Group") has developed next generation microdisplays, electronics, optics and laser systems for projection technologies and is currently in the process of bringing these innovations to commercial success.

The Group has leading technology and holds over 125 patents in core aspects of its business, has world class manufacturing facilities and operations, and a staff of industry experts with a high density of PhDs and a highly skilled workforce.

The Group operates out of its USA facilities in Chicago, Illinois; Madison, Wisconsin; Phoenix, Arizona and Vancouver, Washington as well as Newton Aycliffe, County Durham, UK.

Manufacturing

The Group continues to invest in production and assembly capacity for their products at the Madison, Phoenix and Newton Aycliffe facilities.

FINANCIAL REVIEW

Turnover grew from £2.734M in 2013 to £9.434M in 2014.

Administrative expenses, which include expenditure on research and development, increased from £19.796M in 2013 to £37.451M in 2014.

Headcount grew from 203 at the end of 2013 to 265 at the end of 2014.

Research and development expenditure increased from £2.292M in 2013 to £13.098M in 2014.

The Group has no borrowings and continues to be funded by its parent, with the introduction of a new investor and new capital in 2014 and 2015.

KEY PERFORMANCE INDICATORS

	2014 £'000	2013 £'000
Turnover from continuing operations	**9,434**	2,734
Total Spend	**42,153**	19,053
Loss on Ordinary Activities Before Tax	**(32,719)**	(16,319)

Turnover in 2014 was more than three times 2013 – in part reflecting a full year of manufacturing at Newton Aycliffe and Madison as opposed to 5 and 9 months respectively in 2013. Likewise the total spend reflects the full year of operating at the two additional sites as well as continued project progression.

PRINCIPAL RISKS AND UNCERTAINTIES

Technical risks

The Group is engaged on research and development in several key areas:

- laser systems
- microdisplays
- electronics
- projectors
- imaging, 3D, spatial and gesture recognition optical components and modules

Each of these projects requires innovation in design, fabrication techniques, materials and process development as well as equipment creation or modification necessary to have a successful outcome.

There are inherent risks associated with potential failures or delays in such innovations which may lead to increased time and/or costs to product launch, but none of them is insurmountable. The company mitigates this risk by having the necessary equipment in-house and the required knowledge has either been practised by staff for years or is within the capabilities of the highly-educated teams engaged on each project.

Financial risks

Income from existing sales and cash would be insufficient to sustain the development of new product lines before the company reaches a cash positive position, as such further funding will be required.

The Group mitigates this risk through regular review of cash flow forecasts and raising of further funding as required. An additional investor was introduced in 2014 and further funding totalling $80,004,822 was raised from the issue of 13,833,860 Ordinary shares.

In the first and third quarters of 2015, resolutions were passed by the Directors for the issuance of 8,474,577 ordinary shares which will raise $50,000,004 of funding to take the Group through to late 2016.

Furthermore the company's subsidiary, Compound Photonics UK Limited, has successfully realised the entire claim of a Let's Grow Grant by Business & Enterprise Commercial Limited on behalf of the Regional Growth Fund. Claims of £2.2M and £0.8M were received in March 2015 and June 2015 respectively.

APPROVAL

This Strategic Report was approved on behalf of the Board on 30th October 2015.

M D Faulkner
Director

The directors present their report together with the audited financial statements for the year ended 31 December 2014.

DIRECTORS

The directors of the company throughout the year were:

B G Bolger
A P A De Cort (appointed 10^{th} March 2014)
M D Faulkner
J P A Fletcher
R C Lind
J A Sachs

DIVIDENDS

The directors do not recommend the payment of a dividend (2013 – nil).

FINANCIAL INSTRUMENTS

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

It is company policy, implemented locally, to assess the credit risk of new customers before entering into supply agreements. Each new customer is analysed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. Purchase limits are established for each customer, which represents the maximum open amount without requiring approval.

Liquidity risk

Liquidity risk arises from the Group's management of working capital. It is the risk that the Group will encounter difficulty in meeting its financial obligations as they fall due.

The Board receives information regarding cash balances on a monthly basis. Please refer to the going concern policy in note 1 of the financial statements for further information.

Foreign exchange risk

Foreign exchange risk arises when the Group enters into transactions denominated in a currency other than its functional currency.

The Group is predominantly exposed to currency risk on purchases made from suppliers based outside of the UK and the US. There are currently no specific measures in place to mitigate this risk other than keen price negotiation by the Group's very experienced procurement team.

POST BALANCE SHEET EVENTS

In 2014 the company's subsidiary, Compound Photonics UK Limited, applied for and was offered a Let's Grow Grant of £3,000,000. The grant covers expenditure on capital equipment and research and development and is offered by Business and Enterprise Commercial Limited on behalf of the Regional Growth Fund. One of the conditions of the grant is the creation of a further 97 jobs in addition to the 78 safeguarded by the company's purchase of the business.

In order to secure the grant a legal charge has been created over freehold property and manufacturing plant and equipment having a value of at least £3 million. The charge is in favour of Business and Enterprise Commercial Limited.

The full grant value has been successfully claimed with £2.2M received in March 2015 and £0.8M received in June 2015.

In addition to this, Compound Photonics UK Limited also completed the sale of 7.7 acres of land at the Newton Aycliffe site. Cash received in respect of this in January 2015 was £1.45M.

LIKELY FUTURE DEVELOPMENTS IN THE BUSINESS OF THE COMPANY

The main focus of the Group is on bringing a new projector product line to market, which is forecast to be in 2016.

RESEARCH AND DEVELOPMENT

The Group continues to invest in research and development. Expenditure incurred to date does not yet satisfy the capitalisation criteria and has been expensed in the income statement. Research costs incurred that did not meet the criteria for capitalisation and were therefore charged to profit or loss totalled £13,097,805 (2013 - £2,292,041).

EXISTENCE OF BRANCHES OF THE COMPANY OUTSIDE OF THE UNITED KINGDOM

The company through its wholly owned subsidiary, Compound Photonics Limited, owns 100% of Compound Photonics U.S. Corporation. Compound Photonics U.S. Corporation is a Delaware corporation with offices located in the states of Arizona, Illinois, Washington and Wisconsin.

DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the strategic report, 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 elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) and applicable law. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit

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 UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They 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.

AUDITORS

All of the directors as at the date of this report have taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information. The directors are not aware of any relevant audit information of which the company's auditor is unaware.

APPROVAL

This Directors' Report was approved by order of the Board on 30th October 2015.

M D Faulkner
DIRECTOR

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COMPOUND PHOTONICS GROUP LIMITED

We have audited the financial statements of Compound Photonics Group Limited for the year ended 31 December 2014 which comprise of the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and company statement of financial position, the consolidated cash flow statement, the consolidated and company statement of changes in equity 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.

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 AUDITORS

As explained more fully in the statement of directors' responsibilities, 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 Financial Reporting Council's (FRC'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 FRC'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 the parent company's affairs as at 31 December 2014 and of the Group's loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

EMPHASIS OF MATTER – GOING CONCERN

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosures made in note 1 to the financial statements concerning the Group's ability to continue as a going concern. Further funds will be required to finance the Group's planned work programme. The directors have not yet raised finance to fund future development and production but are confident of being able raise the funding; however there can be no guarantee that it will be raised within the necessary timeframe. The directors have agreed alternative plans to fund the ongoing liabilities should this funding not be achieved or achieved within the timeframe expected. These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the company was unable to continue as a going concern.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion 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.

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.

BDO LLP

John Everingham
For and on behalf of BDO LLP, statutory auditor
Gatwick
Date 5 November 2015

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Compound Photonics Group Limited

Consolidated income statement
for the year ended 31 December 2014

	Note	2014 £'000	2013 £'000
Turnover	4	**9,434**	2,734
Cost of sales		**(3,697)**	(1,457)
Gross profit		**5,737**	1,277
Distribution costs		**(39)**	(41)
Administrative expenses		**(37,451)**	(19,796)
Gain on bargain purchase		-	2,649
Other operating income		**162**	161
Group operating loss	5	**(31,591)**	(15,750)
Interest receivable		-	3
Other finance costs – Net Foreign Exchange Loss	6	**(1,128)**	(572)
Loss on ordinary activities before tax		**(32,719)**	(16,319)
Corporation tax		-	-
Loss for the financial year		**(32,719)**	(16,319)

All amounts relate to continuing activities.

The notes on pages 16 to 39 form part of these financial statements.

Compound Photonics Group Limited

Consolidated statement of comprehensive income
for the year ended 31 December 2014

	Note	2014 £'000	2013 £'000
Loss for the financial year		**(32,719)**	(16,319)
Items that will or may be reclassified to profit or loss:			
Exchange translation differences on retained losses		**(220)**	(397)
Items that will not be reclassified to profit or loss:			
Gain on freehold land and buildings revaluation	**12**	**510**	350
Total comprehensive loss for the year		**(32,429)**	(16,366)

The notes on pages 16 to 39 form part of these financial statements.

Compound Photonics Group Limited

Consolidated statement of financial position
at 31 December 2014

	Note	2014 £'000	2013 £'000
Non-current assets			
Intangible assets	11	**2,351**	2,583
Property, plant and equipment	12	**14,984**	8,354
		17,335	10,937
Current assets			
Stocks	14	**1,318**	898
Trade and other debtors	15	**3,975**	4,349
Cash and cash equivalents		**8,629**	726
		13,922	5,973
Creditors: amounts falling due within one year	16	**(6,554)**	(7,501)
Net current (liabilities)/assets		**7,368**	(1,528)
Total assets less current liabilities		**24,703**	9,409
Creditors: amounts falling due after one year	17	**(2,117)**	(2,403)
Total net assets/(liabilities)		**22,586**	7,006
Capital and reserves			
Called up share capital	18	**32**	18
Share premium account		**99,159**	51,369
Foreign exchange reserves		**282**	502
Revaluation reserve		**860**	350
Merger reserve		**6,501**	6,501
Retained losses		**(84,248)**	(51,734)
Shareholders' funds		**22,586**	7,006

The financial statements were approved by the Board of Directors and authorised for issue on 30th October 2015.

M D Faulkner
Director
Company number 06917133

Compound Photonics Group Limited

Consolidated statement of changes in equity for the year ended 31 December 2014

	Share capital £'000	Share premium £'000	Foreign exchange reserve £'000	Revaluation reserve £'000	Merger reserve £'000	Retained losses £'000	Total £'000
1 January 2012	10	27,591	812	-	6,501	(20,137)	14,777
Total comprehensive loss for the year	-	-	87	-	-	(16,059)	(15,972)
Share-based payment credit	-	-	-	-	-	285	285
1 January 2013	10	27,591	899	-	6,501	(35,911)	(910)
Shares issued	8	23,778	-	-	-	-	23,786
Total comprehensive loss for the year	-	-	(397)	350	-	(16,319)	(16,366)
Share-based payment credit	-	-	-	-	-	496	496
31 December 2013	18	51,369	502	350	6,501	(51,734)	7,006

	Share capital £'000	Share premium £'000	Foreign exchange reserve £'000	Revaluation reserve £'000	Merger reserve £'000	Retained losses £'000	Total £'000
1 January 2014	18	51,369	502	350	6,501	(51,734)	7,006
Shares issued	14	47,790	-	-	-	-	47,804
Total comprehensive loss for the year	-	-	-	-	-	(32,719)	(32,719)
Other comprehensive losses	-	-	(220)	510	-	-	290
Share based payment	-	-	-	-	-	205	205
31 December 2014	**32**	**99,159**	**282**	**860**	**6,501**	**(84,248)**	**22,586**

The notes on pages 16 to 39 form part of these financial statements.

Compound Photonics Group Limited

Consolidated cash flow statement
for the year ended 31 December 2014

	Note	2014 £'000	2013 £'000
Cash flows from operating activities			
Loss for the financial year		**(32,719)**	(16,319)
Adjustments for:			
- Gain on bargain purchase		-	(2,649)
- Depreciation	12	**506**	389
- Amortisation		**359**	295
- Loss on disposal of property, plant and equipment		-	25
- Interest receivable		-	(3)
- Unrealised exchange rate (gain)/loss		**(718)**	(342)
- Share based payment		**205**	496
- (Increase)/decrease in trade and other debtors		**374**	(2,772)
- Decrease/(Increase) in stocks		**(420)**	629
- Increase/(decrease) in trade and other creditors		**(1,233)**	957
Cash used by operations		**(33,646)**	(19,294)
Interest paid		-	-
Corporation tax		-	-
Net cash used by operating activities		**(33,646)**	(19,294)
Cash flows from investing activities			
Purchases of tangible fixed assets	12	**(6,035)**	(1,983)
Proceeds from sale of tangible fixed assets	12	-	103
Acquisition of business combinations, net of cash acquired		-	(3,606)
Interest received		-	3
Net cash used by investing activities		**(6,035)**	(5,483)
Cash flows from financing activities			
Proceeds from issue of ordinary shares		**47,584**	23,785
Net cash from financing activities		**47,584**	23,785
Net increase/(decrease) in cash and cash equivalents		**7,903**	(992)
Cash and cash equivalents at beginning of year		**726**	1,718
Cash and cash equivalents at end of year		**8,629**	726
Cash and cash equivalents comprise:			
Cash at bank and in hand		**8,629**	726

The notes on pages 16 to 39 form part of these financial statements.

Compound Photonics Group Limited

Company statement of financial position
at 31 December 2014

Company number 06917133

	Note	2014 £'000	2013 £'000
Non-current assets			
Investments	13	**6,504**	6,504
Current assets			
Debtors	15	**92,693**	48,811
Cash and cash equivalents		**7,478**	326
		100,171	49,137
Creditors: amounts falling due within one year	16	**(2,786)**	(2,739)
Net current assets/(liabilities)		**97,385**	46,398
Total assets less current liabilities		**103,889**	52,902
Creditors: amounts falling due after one year	17	**-**	-
Total net assets/(liabilities)		**103,889**	**52,902**
Capital and reserves			
Called up share capital	18	**32**	18
Share premium account		**99,159**	51,369
Merger reserve		**6,501**	6,501
Retained losses		**(1,803)**	(4,986)
Shareholders' funds		**103,889**	52,902

The financial statements were approved by the Board of Directors and authorised for issue on 30th October 2015.

M D Faulkner
Director

The notes on pages 16 to 39 form part of these financial statements.

Compound Photonics Group Limited

Company statement of changes in equity
for the year ended 31 December 2014

	Share capital £'000	Share premium £'000	Merger reserve £'000	Retained losses £'000	Total £'000
1 January 2014	18	51,369	6,501	(4,986)	52,902
Shares issued	14	47,790	-	-	47,804
Profit/ (Loss) for the year	-	-	-	3,183	3,183
Share-based payment credit	-	-	-	-	-
31 December 2014	32	99,159	6,501	(1,803)	103,889

The notes on pages 16 to 39 form part of these financial statements.

1 Accounting policies

Basis of presentation

These financial statements have been prepared in accordance with International Financial Reporting Standards, International Accounting Standards and Interpretations (collectively IFRS) issued by the International Accounting Standards Board (IASB) and adopted by the European Union (adopted IFRSs) and in accordance with IFRS as issued by the IASB.

Basis of consolidation

The consolidated financial statements present the results of the Group as if they formed a single entity. Intercompany transactions and balances between Group companies are therefore eliminated in full.

The consolidated financial statements incorporate the results of business combinations using the purchase method. In the statement of financial position, the acquiree's identifiable assets, liabilities and contingent liabilities are initially recognised at their fair values at the acquisition date. The results of acquired operations are included in the consolidated statement of comprehensive income from the date on which control is obtained. They are deconsolidated from the date control ceases.

An entity is treated as an associated undertaking where the Group exercises significant influence in that it has the power to participate in the operating and financial policy decisions. The Group has no associates.

Going concern

An additional investor was introduced in 2014 and further funding totalling $80,004,822 was raised from the issue of 13,833,860 ordinary shares.

In the first and third quarters of 2015, resolutions were passed by the Directors for the issuance of 8,474,577 ordinary shares which will raise $50,000,004 of funding to take the Group through to late 2016.

Based on current forecasts this funding is expected to support the Group, and its current project development plan, through to late 2016. Income from existing sales and cash would be insufficient to sustain the Group's development of new product lines before the Group reaches a cash positive position. Further funding is to be sought in September 2016 in-line with a three year plan presented to the existing investors, these requirements were in line with previous forecasts. The directors are confident that additional funding will be raised as the existing investors have expressed an interest in continuing to fund the business.

Given the above, the directors acknowledge that there is a material uncertainty related to these events, which may cast significant doubt on the Group's ability to continue as a going concern.

The Group has faced this matter previously and always raised the required funds. If further funding is not received the development activities associated with new product lines would be halted. The directors have prepared forecasts based on necessary expenditure over the review period, namely 12 months from the date these financial statements were approved, to maintain its current product lines and sales and therefore have a reasonable expectation that the Group has adequate resources to continue in existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

1 **Accounting policies** *(continued)*

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 company's functional and the Group's presentation currency.

On consolidation, the results of overseas operations are translated into sterling at rates approximating to those ruling when the transactions took place. All assets and liabilities of overseas operations are translated at the rate ruling at the reporting date. Exchange differences arising on translating the opening net assets at opening rate and the results of overseas operations at actual rate are recognised in other comprehensive income.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. 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 profit or loss.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within other finance costs. All other foreign exchange gains and losses are presented in profit or loss within other operating income.

Revenue

Revenue from the sales of goods is recognised when the Group has transferred the significant risks and rewards of ownership to the buyer and it is probable that the Group will receive the previously agreed upon payment. These criteria are considered to be met when the goods are delivered to the buyer.

Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of a business combination over the fair value of the Group's share of the net identifiable assets of the business at the date of acquisition. Goodwill on acquisitions of businesses is included in intangible assets. Goodwill is carried at cost less accumulated impairment losses. Goodwill is not amortised. At each reporting date, the Group assesses whether there is any indication that goodwill may be impaired. If any such indication exists, the entity estimates the recoverable amount of the asset. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units (CGUs) (or Groups of CGUs) for the purpose of impairment testing. The allocation is made to those CGUs or Groups of CGUs that are expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

1 Accounting policies *(continued)*

(a) Negative goodwill

Where the fair value of identifiable assets, liabilities and contingent liabilities exceed the fair value of consideration paid, the excess is recognised immediately in the income statement.

(b) Customer related intangible assets

Separately acquired customer-related intangible assets acquired in a business combination are recognised at fair value at the acquisition date. Customer-related intangible assets have a finite useful life and are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation is calculated using the straight-line method to allocate the cost of customer related intangible assets over their estimated useful lives, as follows:

Customer-related intangible assets	-	1.76 years

(c) Internally generated intangible assets (development costs)

Expenditure on internally developed products is capitalised if it can be demonstrated that:

- it is technically feasible to develop the product for it to be sold;
- adequate resources are available to complete the development;
- there is an intention to complete and sell the product;
- the company is able to sell the product;
- sale of the product will generate future economic benefits; and
- expenditure on the project can be measured reliably.

Capitalised development costs are amortised over the periods the company expects to benefit from selling the products developed. The amortisation expense is included within administrative expenses in the statement of comprehensive income.

Development expenditure not satisfying the above criteria and expenditure on the research phase of internal projects are recognised in the statement of comprehensive income as incurred.

Tangible fixed assets

Tangible fixed assets are stated at historical cost less accumulated depreciation and any accumulated impairment losses. Historical cost includes expenditure that is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Repairs and maintenance are charged to profit or loss during the period in which they are incurred.

Freehold land and buildings are carried at fair value, based on periodic valuations by a professionally qualified valuer. These revaluations are made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Changes in fair value are recognised in other comprehensive income and accumulated in the revaluation reserve except to the extent that any decrease in value in excess of the credit balance on the revaluation reserve, or reversal of such a transaction, is recognised in profit or loss.

1 Accounting policies *(continued)*

Freehold land is not depreciated. Depreciation on assets under construction does not commence until they are complete and available for use. Depreciation is provided on all other items of property, plant and equipment so as to write off their carrying value over their expected useful economic lives. It is provided at the following rates:

Building Plant and Facilities	-	10 to 15 years
Manufacturing plant and equipment	-	10 years with a 35% residual value
Computer and office equipment, furniture and fixtures	-	5 years

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted prospectively if appropriate, if there is an indication of a significant change since the last reporting date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within administrative expenses in the income statement.

Impairment of fixed assets and goodwill

Assets that are subject to depreciation or amortisation are assessed at each reporting date to determine whether there is any indication that the assets are impaired. Where there is any indication that an asset may be impaired, the carrying value of the asset (or cash-generating unit to which the asset has been allocated) is tested for impairment. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's (or CGU's) fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs). Non-financial assets that have been previously impaired are reviewed at each reporting date to assess whether there is any indication that the impairment losses recognised in prior periods may no longer exist or may have decreased.

Valuation of investments

Investments in subsidiaries are measured at cost less accumulated impairment. Where merger relief is applicable, the cost of the investment in a subsidiary undertaking is measured at the nominal value of the shares issued together with the fair value of any additional consideration paid.

Leased assets

Where substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred to the company (a finance lease), the asset is treated as if it had been purchased outright. The amount initially recognised as an asset is the lower of the fair value of the leased property and the present value of the minimum lease payments payable over the term of the lease. The company does not hold any assets under finance leases.

Where substantially all of the risks and rewards incidental to ownership are not transferred to the company (an operating lease), the total rentals payable under the lease are charged to the statement of comprehensive income on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognised as a reduction of the rental expense over the lease term on a straight-line basis.

Lease incentives primarily include up-front cash payments or rent-free periods. Lease incentives are capitalised and spread over the period of the lease term.

1 Accounting policies *(continued)*

Stocks

Stocks are stated at the lower of cost and estimated selling price less costs to complete and sell. 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, other direct costs and related production overheads (based on normal operating capacity).

At each reporting date, stocks are assessed for impairment. If stock value is impaired, the carrying amount is reduced to its selling price less costs to complete and sell; the impairment loss is recognised immediately in profit or loss.

Cash and cash equivalents

Cash and cash equivalents includes cash on hand, demand deposits and other short-term highly liquid investments with original maturities of three months or less. The Group has no bank overdrafts.

Derivative financial instruments and hedging activities

The Group has no derivative financial instruments or hedging activities.

Government grants

Grants from the government are recognised at their fair value in profit or loss where there is a reasonable assurance that the grant will be received and the Group has complied with all attached conditions. Grants received where the Group has yet to comply with all attached conditions are recognised as a liability (and included in deferred income within trade and other payables) and released to income when all attached conditions have been complied with. Government grants received are included in other operating income in the income statement.

Deferred taxation

Deferred tax assets and liabilities are recognised where the carrying amount of an asset or liability in the statement of financial position differs from its tax base, except for differences arising on:

- the initial recognition of goodwill;
- the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit; and
- investments in subsidiaries and jointly controlled entities where the company is able to control the timing of the reversal of the difference and it is probable that the difference will not reverse in the foreseeable future.

Recognition of deferred tax assets is restricted to those instances where it is probable that taxable profit will be available against which the difference can be utilised.

The amount of the asset or liability is determined using tax rates that have been enacted or substantively enacted by the reporting date and are expected to apply when the deferred tax liabilities/(assets) are settled/(recovered).

1 Accounting policies *(continued)*

Pension costs

Contributions to the Group's defined contribution pension schemes are charged to profit or loss in the year in which they become payable.

Holiday pay accrual

A liability is recognised to the extent of any unused holiday pay entitlement which has accrued at the balance sheet date and carried forward to future periods. This is measured at the undiscounted salary cost of the future holiday entitlement so accrued at the balance sheet date.

Financial liabilities and equity

Financial instruments issued by the company are classified as equity only to the extent that they do not meet the definition of a financial liability or financial asset.

The company's ordinary shares are classified as equity instruments.

Share Options

The Group operates a discretionary equity-settled, share-based option plan. The fair value of the options granted is measured by reference to the estimated fair value at the grant date of equity instruments granted and is recognised as an expense over the vesting period. The estimated fair value of the option granted is calculated using a Black-Scholes pricing model. The total amount expensed is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

2 Judgements in applying accounting policies and key sources of estimation uncertainty

Estimates and judgements are continually evaluated. They are based on historical experience and other factors, including expectations of the future.

In preparing these financial statements, the directors have made the following judgements:

- whether leases entered into by the Group either as a lessor or a lessee are operating or finance leases. These decisions depend on an assessment of whether the risks and rewards of ownership have been transferred from the lessor to the lessee on a lease by lease basis.
- whether there are indicators of impairment of the Group's tangible and intangible assets, including goodwill. Factors taken into consideration in reaching such a decision include the economic viability and expected future financial performance of the asset and where it is a component of a larger cash-generating unit, the viability and expected future performance of that unit.

2 Judgements in applying accounting policies and key sources of estimation uncertainty (continued)

Key sources of estimation uncertainty

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 within the next financial year are disclosed below.

(a) Fair value of freehold property

The fair value of freehold property is derived from the current market prices of comparable real estate. The fair value is based on a valuation made by an independent appraiser who falls within the requirements as to competence set out in PS 2.3 of the *RICS Valuation – Professional Standards (Incorporating the International Valuation Standards) January 2014* issued by the Royal Institution of Chartered Surveyors (the 'Red Book'). The valuer is registered in accordance with the RICS Valuer Registration Scheme (VRS).

(b) Fair value of share options issued to employees

The Group uses a Black-Scholes model to determine the fair value of share options granted to employees. Use of such a model involves a number of assumptions including the following:

- Market price of the company's ordinary shares, which is also the exercise price of the option;
- Volatility of the company's share price;
- Discount rate; and
- Expected life of the options.

As the Group's shares are not traded in an active market, the market price and volatility of the Group's ordinary shares are based on the directors' best estimates of these parameters, taking into account all relevant information that is available to them. The discount rate is based on the risk-free rate of government bonds with a four-year term in the UK. The expected life of the option is based on historical experience of exercises by option holders.

Change in accounting estimate

As the new product development matures the directors have been able to reassess the capability and lifetime of the fixed assets. As a consequence of this assessment the depreciation rates schedules have been revised to reflect an increased lifetime and retained value of the manufacturing plant and equipment fixed assets. The change in accounting estimate has been accounted for prospectively and the impact of this in the current period is £359,000.

3 Financial instruments – risk management

The Group is exposed through its operations to the following financial risks:

- Credit risk;
- Fair value or cash flow interest rate risk;
- Foreign exchange risk; and
- Liquidity risk.

In common with all other businesses, the Group is exposed to risks that arise from its use of financial instruments. This note describes the Group's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

3 Financial instruments – risk management (continued)

There have been no substantive changes in the Group's exposure to financial instrument risks, its objectives, policies and processes for managing those risks or the methods used to measure them from previous periods unless otherwise stated in this note.

(i) Principal financial instruments

The principal financial instruments used by the Group, from which financial instrument risk arises, are as follows:

- Trade receivables
- Cash and cash equivalents
- Trade and other payables

(ii) Financial instruments by category

Financial assets

Loans and receivables	**2014 £'000**	**2013 £'000**
Cash and cash equivalents	**8,629**	726
Trade and other debtors	**3,633**	4,349
Total financial assets	**12,262**	5,075

Financial liabilities

The Group's only financial liabilities are trade and other payables as disclosed in notes 16/17.

(iii) Financial instruments not measured at fair value

Financial instruments not measured at fair value includes cash and cash equivalents, trade and other receivables, and trade and other payables.

Due to their short-term nature, the carrying value of cash and cash equivalents, trade and other receivables, trade and other payables approximates their fair value.

The Group has no other financial instruments.

3 Financial instruments – risk management *(continued)*

General objectives, policies and processes

The Board has overall responsibility for the determination of the Group's risk management objectives and policies and, whilst retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the Group's finance function. The Board receives monthly reports from the finance function through which it reviews the effectiveness of the processes put in place and the appropriateness of the objectives and policies it sets.

The overall objective of the Board is to set policies that seek to reduce risk as far as possible without unduly affecting the Group's competitiveness and flexibility. Further details regarding these policies are set out below:

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations

It is company policy, implemented locally, to assess the credit risk of new customers before entering into supply agreements. Each new customer is analysed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. Purchase limits are established for each customer, which represents the maximum open amount without requiring approval.

Further disclosures regarding trade and other receivables, which are neither past due nor impaired, are provided in note 15.

Fair value and cash flow interest rate risk

The Group has no borrowings and therefore no exposure to cash flow interest rate risk. None of the financial instruments are at fair value.

Foreign exchange risk

Foreign exchange risk arises when the Group enters into transactions denominated in a currency other than its functional currency.

The Group is predominantly exposed to currency risk on purchases made from suppliers based outside of the UK and the US. There are currently no specific measures in place to mitigate this risk other than keen price negotiation by the Group's very experienced procurement team.

Liquidity risk

Liquidity risk arises from the Group's management of working capital. It is the risk that the Group will encounter difficulty in meeting its financial obligations as they fall due.

The Board receives information regarding cash balances on a monthly basis. Three year cash forecasts are prepared and reviewed at a six monthly interval from which capital injections were duly secured in March 2014, March 2015 and August 2015.

4 Analysis of turnover

Analysis by country of destination:	2014 £'000	2013 £'000
United Kingdom	**7,185**	1,655
Rest of Europe	**878**	187
United States and Canada	**1,202**	880
Rest of the world	**169**	12
Total	**9,434**	2,734

5 Operating loss

	2014 £'000	2013 £'000
Operating loss is stated after charging/(crediting):		
Fees payable to the company's auditor and it associates for the audit of the company's annual accounts	**16**	15
Fees payable to the company's auditor and it associates for other services to the Group:		
- The audit of the company's subsidiaries pursuant to legislation	**48**	57
- Taxation compliance services	**5**	5
Unrealised net (gain)/loss on foreign currency translation	**(1,127)**	584
Depreciation of tangible fixed assets	**506**	389
Amortisation of intangible fixed assets	**359**	295
Research and development expenditure	**13,098**	2,292
Share based payment	**205**	496

6 Other finance costs

	2014 £'000	2013 £'000
Net foreign exchange loss	**1,128**	572

7 Employees

Staff costs consist of:	2014 £'000	2013 £'000
Wages and salaries	**10,964**	6,819
Social security costs	**897**	973
Cost of defined contribution scheme	**210**	71
	12,071	7,863

The average number of employees during the year was as follows:

	2014 Number	2013 Number
	241	130

The Group operates a defined contribution pension scheme for its employees in the US. The Group does not currently make any contributions to the scheme.

A defined contribution pension scheme is operated by the Group on behalf of the employees of one of the UK subsidiary undertakings. The assets of the scheme are held separately from those of the Group in an independently administered fund. The pension charge represents contributions payable by the Group to the fund and amounted to £209,828 (2013 - £71,229). Contributions amounting to £41,114 (2013 - £28,564) were payable to the fund at 31 December 2014 and are included in creditors.

8 Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, including the directors of the company listed in the Directors' Report on page 4.

Dr Sachs and Dr Lind are US citizens who are both resident in the US. They are paid by Compound Photonics U.S. Corporation for management and consulting services respectively provided to that company in the US for services unrelated to their roles as Directors of the Company.

The members of the Board are not entitled to any remuneration in their capacity as Directors.

	2014 £'000	2013 £'000
Salary	**1,118**	766
Consultancy fees	**182**	209
Other long-term benefits	**21**	4
Share based payment expense	**86**	194
	1,407	1,173

9 Taxation

UK corporation tax	**2014**	**2013**
	£'000	**£'000**
Current tax on profits for the year	-	-
Adjustments in respect of prior periods – R&D tax credit	-	-
Total current tax	-	-
Deferred taxation		
Movement in the period	-	-
Taxation on profit ordinary activities	-	-

The actual tax charge for the current and preceding period differs from that resulting from applying the standard rate of corporation tax in the UK of 21.5% (2013 – 20%) for the reasons set out in the following reconciliation:

	2014	**2013**
	£'000	**£'000**
Loss on ordinary activities before tax	**(32,719)**	(16,319)
Tax on loss on ordinary activities at standard rate	**(7,031)**	(3,264)
(Add)/less tax effect of:		
Expenses not deductible for tax purposes	**31**	134
Capital allowances in the current period in excess of depreciation	-	(31)
Adjustment for R&D tax credit in prior year	-	-
Difference in tax rates	**(4,511)**	-
Losses incurred in the year	**11,511**	3,367
Taxation on profit ordinary activities	-	-

Deferred Tax

A deferred tax asset has not been recognised in respect of timing differences relating to excess tax losses carried forward and capital allowances in excess of depreciation, as there is insufficient evidence that the asset would be recoverable. The amount of this asset that is not recognised is £29,636,699 (2013 – £2,645,484). The asset would be recoverable if sufficient taxable profits are made in the future.

10 Parent company loss for the year

The company has taken advantage of the exemption allowed under section 408 of the Companies Act 2006 and has not presented its own statement of comprehensive income in these financial statements. The Group loss for the year includes a loss of £2,106,517 (2013 - £2,156,751) which is dealt with in the financial statements of the parent company.

11 Intangible assets

Group	Goodwill £'000	Technology & customer related £'000	Patents & intellectual property £'000	Total £'000
Cost or valuation				
At 1 January 2014	569	1,738	854	3,161
Foreign exchange rate movement	36	111	-	147
At 31 December 2014	605	1,849	854	3,308
Amortisation				
At 1 January 2014	-	238	340	578
Charge for the year	-	302	57	359
Foreign exchange rate movement	-	20	-	20
At 31 December 2014	-	**560**	**397**	**957**
Carrying amount				
At 31 December 2014	**605**	**1,289**	**457**	**2,351**
At 31 December 2013	569	1,500	514	2,583

The carrying amount of goodwill is allocated to cash generating units ("CGUs") as follows:

	2014 £'000	2013 £'000
Compound Photonics U.S. Corporation – laser manufacturing Wisconsin	**605**	569

The recoverable amounts of the above CGU has been determined using the market approach based on the guideline public company method. Sales revenue forecasts are based on contracts and order books. The multiple used of 8.8 was determined by finding the mean Enterprise Value/Sales Ratio of comparable companies.

If the multiple was reduced to 6.5, the carrying amount and recoverable amount would be equal.

The recoverable amount of the CGU that holds the Group's goodwill balance is £966,601 which exceeds its carrying amount by £397,544.

12 Property, plant and equipment

Group	Freehold land & buildings £'000	Manufacturing plant & equipment £'000	Computer and office equipment, furniture and fixtures £'000	Asset under construction £'000	Total £'000
Cost or valuation					
At 1 January 2014	3,020	5,821	726	640	10,207
Additions	-	2,776	(212)	3,471	6,035
Transfers	-	427	-	(427)	-
Revaluation	510	-	-	-	510
Disposals	-	-	-	-	-
Exchange	-	665	6	55	726
At 31 December 2014	**3,530**	**9,689**	**520**	**3,739**	**17,478**
Depreciation					
At 1 January 2014	-	1,727	126	-	1,853
Charge for the year	-	423	83	-	506
Exchange	-	150	(15)	-	135
At 31 December 2014	**-**	**2,300**	**194**	**-**	**2,494**
Carrying amount					
At 31 December 2014	**3,530**	**7,389**	**326**	**3,739**	**14,984**
At 31 December 2013	3,020	4,734	600	-	8,354

The Group does not lease any vehicles or machinery under non-cancellable finance lease agreements.

Freehold land and buildings
The company owns the freehold land and buildings and has no borrowings against them.

12 Property, plant and equipment *(continued)*

Fair value measurement (Revalued Property)

The company's freehold property was last valued at 24 September 2014 on a fair value basis by a qualified valuer from Colliers International (Colliers), an independent firm of chartered surveyors. The valuation was carried out in accordance with guidance issued by the Royal Institution of Chartered Surveyors.

In the opinion of Colliers Fair Value at the valuation date was equivalent to Market Value. Colliers considered that there would be no demand for the building in the current arrangement, nor was it likely that it could be adapted for re-use. In Collier's opinion a purchaser in the open market would seek to remove the existing buildings and redevelop the site at an estimated cost of £50,000. The relatively low demolition cost estimate is due to the probability that the contractor would be able to recover a significant amount of scrap value.

The fair value of land and buildings is a level 3 recurring fair value measurement. The fair values of land are derived using the sale comparison approach. Sale prices of comparable land in similar locations are adjusted for differences in key attributes such as land size. The valuation model is based on price per acre.

The only change to the fair value of land and buildings is due to the increase in the market price of land. The fair value of the building is unchanged.

The carrying amount that would have been recognised had the assets been carried under the cost model would have been £2,670,000 (2013 - £2,670,000). The revaluation surplus (gross of tax) amounted to £510,000 (2013 - £350,000).

13 Fixed asset investments

Company

	£'000
Cost	
At 1 January 2014 and as at 31 December 2014	6,504

The company owns 100% of the share capital of the following UK subsidiaries:

	Class of share held	**Number of shares held**	**Nature of business**
Compound Photonics Limited	Ordinary £0.001	3,149,910	Research and development
Compound Photonics UK Limited	Ordinary £1.00	1	Research, development and semiconductor manufacturing

The company also indirectly owns 100% of the share capital of Compound Photonics U.S. Corporation, a company incorporated in the US.

14 Stocks

	Group 2014 £'000	Group 2013 £'000	Company 2014 £'000	Company 2013 £'000
Raw materials	**646**	898	**-**	-
Work in progress	**472**	-	**-**	-
Finished goods	**200**	-	**-**	-
	1,318	898	**-**	-

15 Debtors

	Group 2013 £'000	Group 2013 £'000	Company 2014 £'000	Company 2013 £'000
Trade receivables – net	**1,174**	1,041	**-**	-
Prepayments	**854**	1,380	**2**	5
Receivables from related parties	**-**	613	**92,661**	48,789
Accrued income	**-**	105	**-**	-
Other receivables	**1,947**	1,210	**30**	17
	3,975	4,349	**92,693**	48,811

Included within trade receivables is an impairment provision of £162,648. (2013 - £115,218). There were no impairment losses in the company (2013 – nil).

Fair value of current trade and other receivables

The carrying amount of short term (less than 12 months) trade and other receivables approximates their fair values.

16 Creditors: amounts falling due within one year

	Group 2014 £'000	Group 2013 £'000	Company 2014 £'000	Company 2013 £'000
Trade payables	**942**	2,306	**25**	16
Amounts due to related parties	**2,745**	2,729	**2,745**	2,596
Social security and other taxes	**120**	95	**-**	103
Deferred rent	**186**	196	**-**	-
Accrued expenses	**1,679**	1,014	**16**	24
Other payables	**882**	1,161	**-**	-
	6,554	7,501	**2,786**	2,739

Fair value of current trade and other payables

The carrying amount of short term (less than 12 months) trade and other payables approximates their fair values.

17 Creditors: amounts falling due after one year

	Group 2014 £'000	Group 2013 £'000	Company 2014 £'000	Company 2013 £'000
Deferred rent	**623**	753	-	-
Deferred consideration	**1,494**	1,359	-	-
Other creditors	**-**	291	-	-
	2,117	2,403	-	-

18 Share capital

	2014 £'000	2014 Number	2013 £'000	2013 Number
Allotted, called up and fully paid				
ordinary shares of £0.001 each	**32**	**31,600,892**	18	17,767,032
B Shares of £0.001 each	**-**	**15,000**	-	15,000
	32	**31,615,892**	18	17,782,032

18 Share capital *(continued)*

Warrants over 2,334,721 ordinary shares (2013 - 2,334,721) are held by Vollin Holdings Limited as at 31 December 2014. The warrants are exercisable at a price of £3.07 per share.

An additional investor was introduced in 2014 and further funding totalling $80,004,822 (£47,804,254) was raised from the issue of 13,833,860 ordinary shares.

In the first and third quarters of 2015, resolutions were passed by the Directors of the next issuance; 8,474,577 Ordinary Shares which will raise $50,000,004 of funding to take the Group through to 2016.

19 Reserves

The following describes the nature and purpose of each reserve within equity:

Reserve	**Description and purpose**
Share capital	Nominal value of share capital subscribed for.
Share premium account	Amount subscribed for share capital in excess of nominal value.
Foreign exchange reserves	Gains/losses arising on retranslating the net assets of overseas operations into pounds sterling. This reserve is not distributable to shareholders.
Revaluation reserve	Gains/losses arising on the revaluation of the company's property (other than investment property). This reserve is not distributable to shareholders.
Merger reserve	Reserves at acquisition of subsidiary acquired in 2009. This reserve is not distributable to shareholders.
Retained earnings	All other net gains and losses, and transactions with owners (e.g. dividends) not recognised elsewhere.

20 Share based payment

Share options are granted to selected employees under an unapproved scheme. The exercise price of the granted options is equal to the estimated market price of the shares on the date of the grant. The options become exercisable (vest) 25% on the anniversary of the option grant date and 25% yearly on each anniversary for the following three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire.

20 Share based payment *(continued)*

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	2014 Average exercise price in £ per share	2014 Number of options	2013 Average exercise price in £ per share	2013 Number of options
At 1 January	**3.03**	**1,016,306**	1.91	169,408
At 31 December	**3.02**	**823,793**	3.03	1,016,306
Exercisable at 31 December	**2.58**	**240,223**	2.58	337,745

The average remaining contractual lives of the options outstanding at the end of the period was 7 years (2013: 9.3 years). At the end of the year these outstanding share options had an exercise price of £3.25 (2013: £3.25).

The weighted average fair value of options granted during the prior period determined using the Black-Scholes valuation model was £1.10 per option. The Black-Scholes option pricing model was used to value the share-based payment awards as it was considered that this approach would result in a materially accurate estimate of the fair value of options granted.

The significant inputs into the model were estimated as:

- Weighted average share price of £3.25 at the grant date;
- Exercise price equal to the estimated weighted average share price;
- Volatility of 42.85%;
- An expected option life of four years; and
- An annual risk-free interest rate of 0.48%.

Expected volatility was determined by reference to the historical volatility of the company's share price over the previous fourteen months. The expected life used in the valuation has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations. The risk free rate is based on the average yield on gilts.

The Group recognised total expenses of £205,317 relating to equity-settled share-based payments in 2014 (2013 – £496,038).

21 Commitments under operating leases

The Group and the company had minimum lease payments under non-cancellable operating leases as set out below:

	Group 2014 £'000	Group 2013 £'000	Company 2014 £'000	Company 2013 £'000
Less than one year	**1,649**	1,324	-	-
One to five years	**2,988**	4,384	-	-
Greater than five years	-	-	-	-
Total	**4,637**	5,708	-	-

22 Related party transactions

Vollin Holdings Limited owned 53% of Compound Photonics Group Limited's Ordinary share capital at 31 December 2014 (2013 – 83%). The ultimate controlling party of the Group is Redrock Group Limited, a company registered in the British Virgin Islands.

Compound Photonics Group Limited is the most senior parent that produces consolidated financial statements available for public use. No other Group accounts are prepared in the UK for the UK entities in the Group.

During the year Compound Photonics Group Limited recharged £61,227 (2013 - £29,308) of expenses to its subsidiary, Compound Photonics UK Limited, at cost.

Compound Photonics Group Limited paid consultancy fees of £91,116 during the year (2013 - £95,920) to Expat Financial Limited, a company of which Mr Faulkner is a director and Compound Photonics U.S. Corporation paid consultancy fees of £91,492 during the year to Dr Lind.

At 31 December 2013 Compound Photonics Limited owed £250,203 to Dr Sachs in respect of accrued consultancy fees for services prior to 2008 (2013 - £235,217). Dr Sachs owed Compound Photonics U.S. Corporation £576,363 in respect of two loans from the company (2013 - £587,939).

The members of the Board are not entitled to any remuneration in their capacity as Directors.

23 Capital commitments

	Group 2014 £'000	Group 2013 £'000	Company 2014 £'000	Company 2013 £'000
Contracted but not provided for	**2,274**	1,578	-	-

24 Post Balance Sheet Events

In 2013 the company's subsidiary, Compound Photonics UK Limited, applied for and was offered a Let's Grow Grant of £3,000,000. The grant covers expenditure on capital equipment and research and development and is offered by Business and Enterprise Commercial Limited on behalf of the Regional Growth Fund. One of the conditions of the grant is the creation of a further 97 jobs in addition to the 78 safeguarded by the company's purchase of the business.

In order to secure the grant a legal charge has been created over freehold property and manufacturing plant and equipment having a value of at least £3 million. The charge is in favour of Business and Enterprise Commercial Limited.

In Q1 2015 the first claim was successfully realised. This was claimed in two parts; £2.2M received March 2015, and £0.8M received June 2015.

In addition to this, Compound Photonics UK Limited also completed the sale of 7.7 acres of land at the Newton Aycliffe site. Cash received in respect of this in January 2015 was £1.45M.

In the first and third quarters of 2015, resolutions were passed by the Directors of the next issuance; 8,474,577 Ordinary Shares which will raise $50,000,004 of funding.

25 Business combinations

Acquisition of assets from Alfalight Inc

On 27 March 2013 Compound Photonics U.S. Corporation acquired certain assets and liabilities from Alfalight, Inc. ("Alfalight"), a laser diode manufacturing business in Madison, Wisconsin, USA, in exchange for consideration of £3,908,521. 21 and a number of Alfalight's staff became employees of Compound Photonics U.S. Corporation on the same date.

The principal reasons for this acquisition were to obtain unique, cutting-edge technology that has a direct application in the development of the Group's innovative products and the availability of a highly educated, skilled and experienced workforce.

The consideration was made up of two elements: an initial cash consideration and an amount placed in escrow for twelve months.

The initial cash consideration was based on a fixed amount of £3,631,879 adjusted for working capital variables as defined in the agreement, which amount was agreed at £25,933 deductible, giving a total of £3,605,886.

The amount placed in escrow amounted to £302,635 and served as a source of indemnification against any claims that Compound Photonics may have had under the acquisition agreement.

Following completion, Compound Photonics U.S. Corporation claimed £75,659 against the consideration held in escrow in accordance with the agreement. The balance on escrow of £227,006 was paid to Alfalight in July 2014.

In calculating the goodwill arising on acquisition, the fair values of the net assets acquired were assessed by a professional third party valuer and adjustments from book value were made where necessary.

25 Business combinations *(continued)*

	Fair value £'000
Fixed assets	
Intangible	1,738
Tangible	1,306
Current assets	
Stocks	322
Trade debtors	131
Total assets	3,497
Creditors due with one year	(157)
Fair value of net assets	3,340
Goodwill (note 11)	569
Total purchase consideration	**3,909**
Purchase consideration settled in cash	3,606
Purchase consideration – cash paid into escrow account	303
Cash outflow on acquisition	**3,909**

The useful economic life of the intangible assets has been estimated to be 21 months, based on the period during which economic benefits are expected to be received. Goodwill is not amortised, but is reviewed for impairment at the year end. The goodwill arising on the acquisition of the assets from Alfalight was not considered to be impaired at 31 December 2014 or at 31 December 2013, refer to note 11 for further detail.

The main factors leading to the recognition of goodwill were:

- The presence of certain intangible assets, such as the assembled workforce of the acquired entity, which do not qualify for separate recognition;
- Plant and equipment cost savings which result in the Group being prepared to pay a premium; and
- The fact that a lower cost of capital is ascribed to the expected future cash flows of the entire operation acquired than might be to individual assets.

The goodwill recognised was deductible for tax purposes.

25 Business combinations *(continued)*

Acquisition of assets from RFMD (UK) Limited

On 24 July 2013 Compound Photonics UK Limited, a newly formed, wholly owned subsidiary of Compound Photonics Group Limited, acquired the assets and business of RFMD (UK) Limited and 78 employees of RFMD (UK) Limited transferred to Compound Photonics UK Limited. The consideration payable was £2,609,263.

The principal reasons for this acquisition were to obtain a top quality manufacturing facility and the services of a highly educated, skilled and experienced workforce.

The consideration is payable in two instalments: £978,474 payable 6 months after completion on 24 January 2014; and £1,630,789 payable three years after completion on 24 July 2016. Given the timing of the payments, the consideration has been present valued using a discount factor of 5%.

In calculating the goodwill arising on acquisition, the fair values of the net assets acquired were assessed by a professional third party valuer and by management and adjustments from book value were made where necessary.

	Fair value £'000
Fixed assets	
Freehold property and land	2,670
Plant and equipment	889
Current assets	
Stocks	1,176
Trade debtors	273
Total assets	5,008
Fair value of net assets	5,008
Bargain purchase gain	(2,649)
Total purchase consideration	**2,359**
Purchase consideration due 24 January 2014	978
Purchase consideration due 24 July 2016	1,631
Imputed interest discounted	(250)
Consideration payable at 31 December 2014	**2,359**

The imputed interest discounted has been apportioned between the amounts payable in January 2014 and July 2016 and included in creditors due within and after one year respectively.

The bargain purchase gain of £2,649,275 was recognised in the income statement in the prior year.

In the prior year the results of the Madison operation of Compound Photonics U.S. Corporation and Compound Photonics UK Limited since the acquisitions were as follows:

25 Business combinations *(continued)*

Period since acquisition	**2013 Compound Photonics U.S. Corporation Madison £'000**	**2013 Compound Photonics UK Limited £'000**	**2013 Total £'000**
Turnover	952	1,782	2,734
Profit for the period since acquisition	519	55	574

If both business combinations had occurred on 1 January 2013 Group revenue would have been £4.7 million and Group operating loss for the period would have been £15.8 million.

Acquisition costs of £377,596 were recognised in the income statement in the prior year.