Registered Number 3986643

IQE Silicon Compounds Limited

Report and financial statements

for the year ended 31 December 2019

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Report and financial statements
for the year ended 31 December 2019

Contents

IQE Silicon Compounds Limited

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Directors and advisers for the year ended 31 December 2019

Director
Dr A W Nelson
Dr G H H Ainsworth (resigned 25 June 2019)
Mr T Pullen (appointed 28 March 2019)

Secretary
Mr J M Howells (resigned 20 December 2019)
Mr T A Dale (appointed 19 March 2020)

Registered Office
Beech House
Pascal Close
St Mellons
Cardiff
South Glamorgan
CF3 0LW

Bankers
HSBC Bank Plc

Strategic report for the year ended 31 December 2019

The directors present their strategic report for the company for the year ended 31 December 2019.

Review of the Business

The principal activity of the company is the manufacture of compound semiconductor wafers or "epiwafers" using a process called epitaxy. The epitaxial growth process is a nanotechnology whereby complex atomic structures are produced under strictly controlled conditions to produce atomically engineered layers of crystalline materials that contain a variety of semiconductor materials. The epitaxial layers are grown onto a wafer and the finished product containing the wafer and its atomically modified surface is known as an 'epiwafer'.

On 3 August 2017 as part of its expansion plan the company signed a lease for a new foundry premises in South Wales. The lease is with the Cardiff City Region and provides the infrastructure needed for the company's expansion in a cost-effective manner. The lease is for 11 years, and provides an option to extend the lease or purchase the freehold. In parallel, the company placed significant orders for new epitaxy equipment to meet the capacity expansion requirements and capitalise on the various opportunities within the photonics and silicon market places.

The new foundry construction and fit out has continued to progress well with the infrastructure phase of the capacity expansion and installation of the first batch of tools completed in 2019. The new 'Mega Foundry' is a state-of-the-art facility capitalising on 30 years of compound semiconductor experience. The first batch of tools are now in production, with space for a ten-fold expansion to address the 3D sensing market which is forecast for exceptional growth.

The continued investment in capacity, capital equipment and process research and development position the company well to meet market and customer demand and take advantage of the opportunities within the compound semiconductor market. The Directors remain positive about the company's prospects for 2020 and beyond.

Financial review

The Company reported revenue for the financial year of £16,799,000 (2018: £2,106,000) and made a loss for the financial year of £2,257,000 (2018: £3,497,000).

The increase in revenue reflects completion of the construction of the new foundry and the operational nature of the first batch of installed tools that have principally been used to supply VCSEL wafers for the 3D sensing market.

The increase in gross profit to £1,121,000 (2018: £607,000 loss) reflects an increase in revenue and VCSEL wafer volumes combined with increasing asset utilisation as volumes continue to ramp following commissioning of the new foundry.

Increases in operating expenses principally relate to costs associated with the new foundry and include certain research and development costs partially offset by research and development expenditure tax credits included within other income.

The reduction in the operating loss for the year to £717,000 (2018: £1,339,000) reflects completion of the construction of the new foundry and a phased commencement in operating activities from Q2 onwards.

Key performance indicators

Given the nature of the business, the Company's directors are of the opinion that analysis using key performance indicators beyond the key financial metrics given above is not necessary for an understanding of the development, performance or position of the business.

Strategic report for the year ended 31 December 2019 (continued)

Principal risks and uncertainties
From the perspective of the Company, the principal risks and uncertainties are integrated with the principal risks of the group. Accordingly, the principal risks and uncertainties of the IQE Plc Group, which include those of the Company, are discussed in the Strategic Report of the Group's annual report, which does not form part of this report.

By order of the Board

Dr A W Nelson
Director
29 September 2020

Directors' report for the year ended 31 December 2019

The directors present their report and the financial statements of the company for the year ended 31 December 2019.

Principal activities
The principle activity of the company is the manufacture of compound semiconductor wafers or "epiwafers" using a process called epitaxy.

Business review and future developments
The business review and future developments are set out in the strategic report on page 2.

Results and dividends
The loss for the financial year amounted to £2,257,000 (2018: £3,497,000).

The directors do not recommend the payment of a dividend (2018: £nil).

Directors
The directors of the Company, who were in office during the year and up to the date of signing the financial statements unless otherwise stated, are set out on page 1.

Research and development
The company incurred costs in respect of research and development during the year of £2,334,606 (2018: £1,482,855). All research and development expenditure is charged to the profit and loss account in the period it is incurred.

Going concern
The Company made a loss of £2,257,000 (2018: £3,497,000) and had a decrease in cash and cash equivalents of £1,658,000 (2018: £1,740,000) for the year ended 31 December 2019.

The following matters have been considered by the directors in determining the appropriateness of the going concern basis of preparation in the financial statements:

- The Company continues to receive the support of its ultimate parent company, IQE plc and the directors have received confirmation that IQE plc intends to support the Company for at least 12 months after these financial statements are approved.

- On 24 January 2019, the Group agreed a new £26,700,000 ($35,000,000) three-year multi-currency revolving credit facility from HSBC Bank plc. The Group has complied with all covenants associated with the facility.

- On 29 August 2019, the Group agreed a new £30,000,000 five-year Asset Finance Loan facility from HSBC Bank plc of which £25,000,000 is drawn down at the date of this report. The Group has complied with all covenants associated with the facility.

- The Group generated cash from operating activities of £8,126,000 (2018: £16,257,000) and its financial forecasts and projections for the period up to and including 31 December 2021 show that the Group is forecast to continue to comply with its banking covenants and has adequate cash resources to continue operating for the foreseeable future.

- On 11 March 2020, the World Health Organisation declared the outbreak of a coronavirus (COVID-19) a pandemic. The COVID-19 outbreak has created significant uncertainty in global economies and the markets in which the Group and Company operate which pose risks to the Group and Company's continuity of business operations, demand for its products and its forecast future financial performance given current world health and global economic conditions.

Directors' report for the year ended 31 December 2019 (continued)

Business Continuity Risk

The Executive Management Board of the Group has set up a Business Continuity Subcommittee, chaired by the Chief Financial Officer, to manage the Group's response to the outbreak of the coronavirus pandemic.

The subcommittee is responsible for monitoring risk indicators, external guidance and maintaining regular communications with employees and other stakeholders. The subcommittee has formulated policies and potential actions in readiness for different scenarios and is working closely with relevant business functions within the Company and wider Group to co-ordinate COVID-19 responses and on-going dialogue with customers and suppliers to ensure that proactive steps are taken to respond to any situation.

The nature of the Company's operations, as a critical semiconductor technology supplier, also means that the Company and its manufacturing site are less likely to be affected by 'lockdown' scenarios than other businesses, something that has been evidenced in the United Kingdom where the Secretary of State, Department for Business, Energy & Industrial Strategy has written to the Company stating that *'manufacturing is a critical part of our economy and I would like to be clear that there is no restriction on manufacturing continuing under the current rules'*.

Manufacturing continues to remain operational and production has not been affected by any disruption at the company's manufacturing site at the date of this report. The Company has introduced social distancing measures at its site and has restricted the numbers of people on site to the minimum essential for production, with other staff working from home. The Company dual or multi-sources key raw materials (substrates, gases, consumables) wherever possible, from a broad range of global suppliers, reducing the likelihood of potential disruption to production from any single supplier. The Company and Group continue to work closely with both suppliers and customers to manage inventory levels in order to create resilience against potential disruption.

Market Conditions

Trading for the first half of 2020 for the IQE Group was slightly above expectations. The smartphone handset market has seen the launch of new models from several OEM's and communications infrastructure related demand linked to 5G deployment, particularly in Asia, shows signs of growth. The Group is also experiencing growth in sales of military infra-red products.

Despite current market conditions, there remains a risk of a global economic downturn which could in turn adversely affect global demand for Smartphones and other electrical devices that incorporate the Company and wider Group's products and/or delay the roll out of 5G communications networks. Such scenarios would adversely affect demand from customers and therefore the financial performance of the Company and Group.

Conversely, at a time of social distancing and self-isolation, with many thousands of people continuing to work at home, demand for smartphone handsets may withstand an economic downturn better than many other sectors. Furthermore, the Company and Group consider it likely that Governments will pursue 5G infrastructure deployments as part of economic stimulus packages as they emerge from the health crisis. There is already some evidence of this in Asia.

Whilst the risk of disruption to supply chains and of economic downturn is likely to remain for some months, the effects on the Company and wider Group's markets are unclear at the date of this report. Due to this, Management and the Directors have considered severe but plausible downside scenarios to the Group's financial forecasts and projections when considering going concern.

Directors' report for the year ended 31 December 2019 (continued)

Financial Forecasts

Severe but plausible downside financial forecasts and projections have been prepared with significant reductions to future forecast revenues, designed to reflect severe downside scenarios associated with COVID-19 disruption and demand risks, for an 18-month period to 30 June 2021. The severe but plausible downside scenario, applied to the Group's financial forecasts, which take account of Q1FY20 trading and customer demand, assume a ~1/3 reduction in revenue in H2 2020 and a ~1/4 reduction in H1 2021 partially offset by controllable working capital and capital expenditure mitigations. The downside scenario illustrates that the Group is forecast to continue to comply with its banking covenants, albeit with reduced covenant headroom, and has adequate cash resources to continue operating for the foreseeable future and meet any required commitment to provide financial support to the Company.

The Group has a long-standing and trusted relationship with its bankers, HSBC Bank plc, who remain supportive. The Group has maintained close on-going dialogue with its bankers regarding the evolving effects and risks of COVID-19 on the business, including discussion of the Group's severe but plausible downside financial forecasts in order to agree the relaxation of certain banking covenants at 31 December 2020 and 30 June 2021 as a precautionary measure designed to increase covenant headroom and availability of cash funding under the terms of the Group's committed bank facilities in the event of a more extreme scenario.

The Group meets its day-to-day working capital and other cash requirements through its bank facilities and available cash. The Group's severe but plausible downside cash flow forecasts and projections, in conjunction with increased covenant headroom following the formal relaxation of certain bank covenants show that the Group has adequate cash resources to continue operating for the foreseeable future such that the directors, after making enquiries and considering the future prospects of the Company have a reasonable expectation that the Company will have adequate resources to continue operating for the foreseeable future with the continued support of the ultimate parent company, IQE plc. The directors have received confirmation that IQE plc intends to support the Company for at least 12 months after these financial statements are approved and therefore the going concern basis has been adopted in preparing these financial statements.

Financial risk management

The Company's activities expose it to a number of financial risks including foreign exchange risk, credit risk and interest rate risk.

Treasury

The IQE group operates a central treasury function which acts in accordance with specific Board policies. Speculative transactions are not permitted.

Interest rate risk

The Group is financed with Group wide facilities therefore interest rate risk is managed on a Group wide basis. The risks associated with changes in interest rates is regularly reviewed by the Group and its exposure to interest rate risk, in particular the mix between fixed and floating rate facilities. The Board does not speculate on future changes in interest rates.

Directors' report for the year ended 31 December 2019 (continued)

Financial risk management (continued)

Currency risk - Cash flow risk
The Company's functional currency is Sterling.

The company has transactional exposure to US dollars. The Company's cash flows are affected by fluctuations in the rate of exchange between Sterling and the US dollar, and to a lesser extent, the Company also has exposures to other currencies including Yen and Euros.

The Group actively seeks to manage this where possible by establishing natural currency hedges, matching the currency of material purchases to the sales made in foreign currency on a group wide basis.

Where this is not possible the Company management team work in conjunction with the Group Treasury team to forecast the foreign currency exposures and monitor foreign currency rates as part of its ongoing evaluation of the cost versus benefit of using forward contracts to manage any residual foreign currency exposure. Any forward cover obtained would be purely for hedging purposes as speculative transactions are not permitted. The Company did not enter into any forward contracts during 2019.

Credit risk
Many of the Company's customers are part of large, multinational, high-tech organisations and the credit risk is therefore generally considered to be relatively low. Where the Company does perceive a credit risk, this is dealt with either by up-front payment prior to the shipment of goods or by other credit risk mitigation measures. As a result the Company has historically had and continues to have a very low level of payment default.

Statement of directors' responsibilities
The directors are responsible for preparing the strategic report, the director's 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 United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting standards, comprising Financial Reporting Standard 102 'The Financial Reporting Standard Applicable in the UK and Republic of Ireland' (FRS 102), and applicable law).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and 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.

Directors' report for the year ended 31 December 2019 (continued)

Qualifying third party indemnity provisions
The company has granted to the Directors of the company a deed of indemnity which constitutes a third-party indemnity provision for the purposes of the Companies Act 2006. In addition, the company has in place appropriate Directors and Officers liability insurance cover which has been in place for the entire year and at the date of approval of the financial statements.

Audit exemption
IQE Silicon Compounds Limited is exempt from the requirements to file audited accounts by virtue of section 479a of the Companies Act 2006. A statutory guarantee has been provided to IQE Silicon Compounds Limited by IQE plc the ultimate controlling party.

By order of the Board

AW Nelson

Dr A W Nelson
Director
29 September 2020

Profit and loss account for the year ended 31 December 2019

	Note	2019 £'000	2018 £'000
Turnover	3	**16,799**	2,106
Cost of sales		**(15,678)**	(2,713)
Gross profit / (loss)		**1,121**	(607)
Distribution costs		**(112)**	(104)
Administrative expenses		**(2,427)**	(712)
Other income		**701**	84
Operating loss	4	**(717)**	(1,339)
Interest payable and similar charges	7	**(2,415)**	(1,223)
Loss on ordinary activities before taxation		**(3,132)**	(2,562)
Tax on loss on ordinary activities	8	**875**	(935)
Loss for the financial year	18	**(2,257)**	(3,497)
Total comprehensive expense for the year		**(2,257)**	(3,497)

All the results derive from continuing activities.

IQE Silicon Compounds Limited

Registered number: 3986643

Balance sheet as at 31 December 2019

	Note	2019 £'000	2018 £'000
Fixed assets			
Intangible assets	9	**170**	175
Tangible assets	10	**48,125**	38,702
		48,295	38,877
Current Assets			
Stocks	12	**3,270**	1,800
Debtors	13	**6,957**	4,548
Cash at bank and in hand		**-**	509
		10,227	6,857
Creditors - amounts falling due within one year	14	**(8,749)**	(14,024)
Net current assets / (liabilities)		**1,478**	(7,167)
Total assets less current liabilities		**49,773**	31,710
Creditors - amounts falling due after more than one year	15	**(55,917)**	(35,645)
Net liabilities		**(6,144)**	(3,935)
Capital and reserves			
Called up share capital	17	**-**	-
Other reserves		**47**	47
Profit and loss account	18	**(6,191)**	(3,982)
Total shareholder deficit		**(6,144)**	(3,935)

Subsidiary Audit Exemption

For the financial year in question the company was entitled to exemption under section 479a of the Companies Act 2006. No members have required the company to obtain an audit of its accounts for the year in question in accordance with section 476 of the Companies Act 2006.

The directors acknowledge their responsibility for complying with the requirements of the Companies Act 2006 with respect to accounting records and for the preparation of accounts.

The financial statements on pages 9 to 32 were approved by the board of directors on 29 September 2020 and were signed on its behalf by:

By order of the board
Dr A W Nelson
Director
29 September 2020

AW Nelson

Statement of changes in equity for the year ended 31 December 2019

	Called up share capital £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
Balance at 1 January 2019	-	47	(3,982)	(3,935)
Loss for the year	-	-	(2,257)	(2,257)
Credit relating to equity settled share based payments	-	-	48	48
Balance at 31 December 2019	**-**	**47**	**(6,191)**	**(6,144)**

	Called up share capital £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
Balance at 1 January 2018	-	47	(521)	(474)
Loss for the year	-	-	(3,497)	(3,497)
Credit relating to equity settled share based payments	-	-	36	36
Balance at 31 December 2018	**-**	**47**	**(3,982)**	**(3,935)**

Notes to the financial statements for the year ended 31 December 2019

1 Accounting policies

General Information
IQE Silicon Compounds Limited researches, develops and manufactures advanced semiconductor materials and technology. The company manufactures in the UK and sells to customers globally.

The company is a private company limited by shares and is incorporated and domiciled in England. The address of the registered office is Beech House, Pascal Close, St Mellons, Cardiff, CF3 0LW.

Statement of compliance
The individual financial statements of IQE Silicon Compounds Limited have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" (FRS102) and the Companies Act 2006.

Summary of significant accounting policies
The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless stated otherwise.

Basis of preparation
These financial statements are prepared on a going concern basis, under the historical cost convention as modified by the revaluation of certain financial assets and liabilities measured at fair value through profit and loss and in accordance with FRS 102 and the Companies Act 2006.

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 2.

Going concern
The company meets its working capital requirements through a combination of cash generated from operations and funding from its ultimate parent company, IQE plc.

The Group meets its day-to-day working capital and other cash requirements through its bank facilities and available cash. The Group's severe but plausible downside cash flow forecasts and projections, in conjunction with increased covenant headroom following the formal relaxation of certain bank covenants show that the Group has adequate cash resources to continue operating for the foreseeable future.

The directors have assessed the Group's funding requirements and after making enquiries, including consideration of the future prospects of the Company have a reasonable expectation that the Company will have adequate resources to continue operating for the foreseeable future with the continued support of the ultimate parent company, IQE plc. The directors have received confirmation that IQE plc intends to support the Company for at least 12 months after these financial statements are approved and therefore the going concern basis has been adopted in preparing these financial statements.

Notes to the financial statements for the year ended 31 December 2019

1 Accounting policies (continued)

Exemptions for qualifying entities under FRS 102
FRS 102 allows certain disclosure exemptions for qualifying entities. The company has taken advantage of available exemptions stated below as the information is contained in the consolidated financial statements of IQE plc as at 31 December 2019 which can be obtained from the Company Secretary at Pascal Close, Cardiff, CF3 0LW.

Cash Flows
The Company has taken advantage of the exemption, under FRS 102 paragraph 1.12(b), from preparing a statement of cash flows on the basis that it is a qualifying entity and its ultimate parent company, IQE plc includes the company's cash flows in its own consolidated financial statements.

Shares & Share Based Payments
The Company has taken advantage of the exemption, under paragraph 1.12(d), from certain share-based payment disclosures on the basis that it is a subsidiary of IQE plc and the share-based payments concern equity instruments of the group entity.

Financial Instruments
The Company has taken advantage of the exemption, under paragraph 1.12(c), from certain financial instrument disclosures on the basis that it is a qualifying entity and its ultimate parent company, IQE plc includes the financial instrument disclosures in its own consolidated financial statements.

Key Management Compensation
The Company has taken advantage of the exemption, under paragraph 1.12(e), from certain key management compensation disclosures on the basis that it is a subsidiary of IQE plc and IQE plc includes this information in its own consolidated financial statements.

Related Party Transactions
The Company has taken advantage of the exemption, under FRS 102 paragraph 33.2, from disclosing transactions with members of the same group that are wholly owned.

Turnover
Revenue is measured at the fair value of the consideration received or receivable and represents the amount receivable for goods supplied or services rendered, net of returns, discounts and rebates allowed by the company and value added taxes.

The company bases its estimates of returns on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Where the consideration receivable in cash or cash equivalents is deferred, and the arrangement constitutes a financing transaction, the fair value of the consideration is measured as the present value of all future receipts using the imputed rate of interest.

Sale of Goods
The company recognises revenue when (a) the significant risks and rewards of ownership have been transferred to the buyer; (b) the company retains no continuing involvement or control over the goods; (c) the amount of revenue can be measured reliably; (d) it is probable that future economic benefits will flow to the entity and (e) when the specific criteria relating to each of the company's sales channels have been met.

1 Accounting policies (continued)

Turnover (continued)

Licence Income
The company earns licence income from other companies in relation to the sale of Intellectual property by the company. License income is recognised on an accrual's basis in accordance with the substance of the relevant agreement.

Research and development
Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.

Operating Leases
Leases that do not transfer all the risks and rewards of ownership are classified as operating leases. Costs in respect of operating leases are charged in arriving at operating profit on a straight-line basis over the lease term.

Employee benefits
The Company provides a range of benefits to employees, including annual bonus arrangements, paid holiday arrangements, defined contribution pension plans and share based payments.

(i) Short term benefits – Short term benefits, including holiday pay and other similar non-monetary benefits, are recognised as an expense in the period in which the service is received.

(ii) Bonuses - An expense is recognised in the profit and loss account for bonuses if the criteria have been met to satisfy the payment of a bonus as a result of past events and a reliable estimate of the obligation can be made.

(iii) Defined contribution pension plans - The Company operates a defined contribution pension scheme. A defined contribution plan is a pension plan under which the company pays fixed contributions into a separate entity. Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the scheme.

(iv) Share based payments - Under the IQE plc Share Option Scheme, the scheme participants are eligible for the grant of share options in the Ultimate Parent Company. These have vesting periods of 3 years and can be exercised within 10 years from the date of grant, subject to performance criteria relating to profitability. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted which is calculated using the Black-Scholes option pricing model.

Notes to the financial statements for the year ended 31 December 2019

1 Accounting policies (continued)

Taxation
Income tax on the profit or loss for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year using rates substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of prior years. Amounts receivable from tax authorities in relation to research and development ('R&D') tax relief claims under the research and development expenditure credit scheme ('RDEC') are recognised within operating profit. Where amounts are outstanding at the year end and have not been formally agreed, an appropriate estimate of the amount is included within other receivables.

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Foreign currency translation
The Company's functional and presentational currency is GBP. Transactions in foreign currencies during the period are recorded in sterling at the rates of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. All exchange differences are taken to the profit and loss account.

Investments in Joint ventures and associates
Investment in Joint ventures and associates is held at cost less accumulated impairment losses.

Intangible fixed assets
Purchased intangible fixed assets are initially recognised at cost. After initial recognition, under the cost model, patent costs are measured at cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation has been calculated so as to write down the cost of assets to their residual values over their estimated useful economic lives. The useful economic lives used are:

Patents	-	15 years

Amortisation is charged to administrative expenses in the profit and loss account.

Intangible fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The directors also review the useful economic life of the assets on an annual basis.

Notes to the financial statements for the year ended 31 December 2019

1 Accounting policies (continued)

Tangible fixed assets
Tangible fixed assets under the cost model are stated at historical cost less accumulated depreciation and provision for impairment. Cost includes the original purchase cost of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Repairs and maintenance costs are expensed as incurred.

Depreciation has been calculated so as to write down the cost of assets to their residual values over their estimated useful economic lives, as follows:

Short leasehold improvements	-	Over period of lease
Plant and machinery	-	5 to 15 years
Fixtures and fittings	-	3 to 5 years

No depreciation is provided on assets in the course of construction. Assets residual values and useful lives are reviewed, and adjusted, if appropriate, at the end of each reporting period. The effect of any change is accounted for prospectively.

Tangible assets are derecognised on disposal or when no future economic benefits are expected. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised in administrative expenses in the profit and loss account.

Impairment of non-financial assets
At each balance sheet date non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset may be impaired. If there is such an indication the recoverable amount of the asset is compared to the carrying amount of the asset.

The recoverable amount of the asset is the higher of the fair value less costs to sell and value in use. Value in use is defined as the present value of the future cash flows before interest and tax obtainable as a result of the asset's continued use. These cash flows are discounted using a pre-tax discount rate that represents the current market risk-free rate and the risks inherent in the asset.

If the recoverable amount of the asset is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the profit and loss account, unless the asset has been revalued when the amount is recognised in other comprehensive income to the extent of any previously recognised revaluation. Thereafter any excess is recognised in profit or loss.

If an impairment loss is subsequently reversed, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the profit and loss account.

Notes to the financial statements for the year ended 31 December 2019 (continued)

1 Accounting policies (continued)

Stocks
Stocks are stated at the lower of cost and net realisable value. Cost includes all costs incurred in bringing each item to its present location and condition including:

- the purchase cost of direct materials on a first-in first-out basis;
- the cost of direct labour (for work in progress and finished goods); and
- the cost of attributable overheads based on normal level of activities.

Provision is made for obsolete and slow moving or defective items where appropriate.

Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities.

Provisions
Provisions are recognised when the company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount of the obligation can be estimated reliably. Provisions are not made for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as a finance cost.

Financial instruments

Financial assets
Basic financial assets, including trade and other receivables, amounts owed by group undertakings and associate and cash and bank balances are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest. Such assets are subsequently carried at amortised cost using the effective interest method.

At the end of each reporting period financial assets measured at amortised cost are assessed for objective evidence of impairment. If an asset is impaired the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognised in profit or loss.

If there is a decrease in the impairment loss arising from an event occurring after the impairment was recognised the impairment is reversed. The reversal is such that the current carrying amount does not exceed what the carrying amount would have been had the impairment not previously been recognised. The impairment reversal is recognised in profit or loss.

Financial assets are derecognised when (a) the contractual rights to the cash flows from the asset expire or are settled, or (b) substantially all the risks and rewards of the ownership of the asset are transferred to another party or (c) control of the asset has been transferred to another party who has the practical ability to unilaterally sell the asset to an unrelated third party without imposing additional restrictions.

Notes to the financial statements for the year ended 31 December 2019 (continued)

1 Accounting policies (continued)

Financial instruments (continued)

Financial liabilities
Basic financial liabilities, including trade and other payables and loans from fellow group companies that are classified as debt, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the debt instrument is measured at the present value of the future receipts discounted at a market rate of interest.

Debt instruments are subsequently carried at amortised cost, using the effective interest rate method.

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognised initially at transaction price and subsequently measured at amortised cost using the effective interest method.

Financial liabilities are derecognised when the liability is extinguished, that is when the contractual obligation is discharged, cancelled or expires.

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.

Notes to the financial statements for the year ended 31 December 2019 (continued)

2 Critical accounting judgements and estimation uncertainty

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical judgements in applying the entity's accounting policies

Associated undertaking – Right of use asset
The Compound Semiconductor Centre Limited ('CSCL') was established on 9 July 2015 by the IQE Group and its joint venture partner as a centre of excellence for the development and commercialisation of advanced compound semiconductor wafer products in Europe.

The company owns a 17% equity stake in CSCL and treats this equity investment as a fixed asset investment.

As part of the initial formation of the CSCL IQE Group entered into an agreement with CSCL that conveys to the company the right to use certain assets of CSCL for a minimum five-year period. This right to the use of CSCL assets has been treated as an operating lease in the application of the Company's accounting policies.

Costs associated with the right to use the assets of the CSCL are charged to the company at a mutually agreed price by the IQE Group and Cardiff University. The price reflects the company's right to use the assets and is variable based on the CSCL's cash cost of production (including direct labour, materials and other foundry costs).

Shared based payments
The company's employees have been granted share options by the ultimate parent company, IQE plc. The company makes use of the exemption in Section 26 of FRS 102 to account for the expense based on a reasonable allocation of the parent's total expense. The company has calculated its allocation of the parent company's total expense based on the number of participating employees in the company.

Critical accounting estimates and assumptions

The company 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 significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Inventory Provisioning
The company manufactures advanced semiconductor materials and is subject to changing demands in new technology. As a result, it is necessary to consider the recoverability of the cost of inventory and the associated provisioning required. When calculating the inventory provision, management considered the nature and the condition of the inventory, as well as applying assumptions around anticipated saleability of finished goods and future usage of raw materials. See note 12 for the net carrying amount of the inventory and associated provision.

Impairment of trade and other debtors
The company makes an estimate of the recoverable value of trade and other debtors. When assessing impairment of trade and other debtors, management considers factors including the current credit rating of the debtor, the age profile of debtor balances and historical collection experience. See note 13 for the net carrying amount of trade and other debtors and associated provision.

Notes to the financial statements for the year ended 31 December 2019 (continued)

2 Critical accounting judgements and estimation uncertainty (continued)

Critical accounting estimates and assumptions (continued)

Impairment of preference share debt
The company classifies its preference share financial assets due from its joint venture, CSCL, as debt instruments.

The carrying value of the company's preference share debt is £154,000 (2018: £309,000) after an impairment of £161,000 (2018: £nil) detailed in note 13.

When measuring impairment on the preference share debt due from CSCL the company uses reasonable and supportable forward-looking information, which is primarily based on assumptions about forecast future financial performance of CSCL.

The company recognises impairment when there has been a significant increase in credit risk associated with the debt instrument since initial recognition, a situation that has been determined in the current year. The significant increase in credit risk has been assessed following review of a combination of factors, including CSCL's progress and achievement against milestones set-out in its original business plan, current cash flow forecasts for CSCL and the capacity of CSCL to redeem the debt.

Impairment has been assessed by reference to expected credit losses that will result from all possible default events over the expected life of the debt instrument and is the difference between the contractual cash flows due and those that the company expects to receive, considering cash flows from any collateral.

Default events and associated probability of default has been assessed by reference to a range of scenarios based principally on assumptions and expectations of the future financial performance of CSCL that have been derived from CSCL's Board approved 2020 Budget and CSCL Management's 2021 and 2022 financial forecasts extrapolated over the repayment period.

If revenue growth in the 2020-2022 CSCL Budget and Management forecasts was restricted to zero the impairment would increase from £161,000 to £315,000.

Deferred tax asset recognition
The Company has deferred tax assets consisting of tax losses and accelerated depreciation. The directors', having considered the future prospects of the company, including the current market opportunities and capacity expansion plan, have concluded that it is appropriate to recognise £3,964,000 of deferred tax assets in respect of the tax losses available. This judgement will be reviewed each reporting period.

Notes to the financial statements for the year ended 31 December 2019 (continued)

3 Turnover

Analysis of the company's turnover by geographical destination is given below:

	2019 £'000	2018 £'000
Europe	**1,875**	1,534
North America	**758**	280
Asia	**14,166**	292
	16,799	2,106

	2019 £'000	2018 £'000
Sale of goods	**16,799**	2,106

Notes to the financial statements for the year ended 31 December 2019 (continued)

4 Operating loss

Operating loss is after charging

	2019 £'000	2018 £'000
Wages and salaries	**2,105**	969
Social security costs	**200**	130
Other pension costs	**132**	94
Shared options costs	**48**	36
Staff Costs	**2,485**	1,229
Amortisation of intangible fixed assets	**18**	16
Depreciation of tangible fixed assets	**1,898**	105
Inventory recognised as an expense	**6,508**	556
Operating lease rentals		
- Plant and equipment	**1,529**	1,442
- Land and buildings	**1,519**	-
Impairment of preference shares	**161**	-
Foreign exchange losses	**217**	15

Staff costs include costs recharged from CSCL for staff who are contracted to CSCL and are recharged as part of the company's contractual right to use the assets of CSCL (see note 2).

Notes to the financial statements for the year ended 31 December 2019 (continued)

5 Employees

The average monthly number of employees during the year was 55 (2018: 31), and was split as follows:

	2019	2018
	No	No
Production	50	26
Selling and distribution	2	3
Administration	3	2
	55	31

6 Directors emoluments

The directors of the company hold their employment contracts with other group companies. The emoluments of the directors are disclosed in the financial statements of IQE plc. No recharge is made for their emoluments as it is not possible to apportion emoluments across the various group companies.

7 Interest payable and similar charges

	2019	2018
	£'000	£'000
Intercompany loans	2,206	1,218
Bank loans and charges	215	15
Unwind of discount on long term balances	(6)	(10)
	2,415	1,223

Notes to the financial statements for the year ended 31 December 2019 (continued)

8 Tax on loss on ordinary activities

	2019 £'000	2018 £'000
Current tax charge	-	-
Deferred tax (credit) / charge	(875)	935
Total tax (credit) / charge	**(875)**	935

The tax assessed for the year is higher (2018: higher) than the standard rate of corporation tax in the UK of 19.00% (2018: 19.00%) and is explained below:

	2019 £'000	2018 £'000
Loss on ordinary activities before taxation	(3,132)	(2,562)
Tax on loss on ordinary activities before taxation at 19.00% (2018: 19.00%)	(595)	(487)
Effects of:		
Expenses not deductible for tax purposes	6	(11)
Impact on deferred tax as a result of changes in tax rates	103	(110)
Income not subject to tax	(1)	17
Adjustments in respect of prior years	(388)	-
Group relief surrendered not paid	-	1,526
Total tax (credit) / charge for the year	**(875)**	935

Deferred tax asset	2019 £'000	2018 £'000
At 1 January	3,089	4,024
Tax credit / (charge) recognised in the year	875	(935)
At 31 December	3,964	3,089

Notes to the financial statements for the year ended 31 December 2019 (continued)

8 Tax on loss on ordinary activities (continued)

Factors that may affect the future tax charge
The deferred tax asset recognised at 31 December 2019 of £3,964,000 (2018: £3,089,000) relates to timing differences primarily consisting of tax losses carried forward and accelerated depreciation. These are recognised to the extent that the realisation of the related tax benefit through future taxable profits from the same trade is probable.

The deferred tax asset has been fully recognised at 31 December 2019 (2018: fully recognised) as it is sufficiently probably that the company will generate sufficient taxable profits against which to offset the carried forward losses.

Finance (No.2) Bill 2016, which was substantively enacted in September 2016, included legislation to reduce the main rate of corporation tax from 20% to 19% from 1 April 2017 with a further reduction to 17% from 1 April 2020. Accordingly, the closing UK deferred tax asset in the financial statements has been recognised in accordance with the rate reductions enacted as part of the Finance (No.2) Bill 2016. The March 2020 Budget announced that a rate of 19% would continue to apply with effect from 1 April 2020, and this change was substantively enacted on 17 March 2020.

9 Intangible fixed assets

	Patents £'000
Cost	
At 1 January 2019	268
Additions	13
At 31 December 2019	**281**
Accumulated amortisation and impairment	
At 1 January 2019	93
Charge for the year	18
At 31 December 2019	**111**
Net book value	
At 31 December 2019	**170**
At 31 December 2018	175

Notes to the financial statements for the year ended 31 December 2019 (continued)

10 Tangible fixed assets

	Short leasehold improvements	Plant and machinery	Fixtures and fittings	Total
	£'000	£'000	£'000	£'000
Cost				
At 1 January 2019	10,235	33,887	691	44,813
Additions	6,896	4,294	131	11,321
At 31 December 2019	**17,131**	**38,181**	**822**	**56,134**
Accumulated depreciation and impairment				
At 1 January 2019	5,781	95	235	6,111
Charge for the year	490	1,275	133	1,898
At 31 December 2019	**6,271**	**1,370**	**368**	**8,009**
Net book value				
At 31 December 2019	**10,860**	**36,811**	**454**	**48,125**
At 31 December 2018	4,454	33,792	456	38,702

11 Fixed asset investments

The company owns a 17% equity interest in the ordinary share capital of Compound Semiconductor Centre Limited, a company incorporated in the United Kingdom whose principal activity is the research, development and manufacture of epitaxial wafers. The registered address of CSCL is Pascal Close, St Mellons, Cardiff, CF3 0LW. The cost of investment in CSCL was £4,040,000 and has been fully provided at 31 December 2019 and 31 December 2018.

Notes to the financial statements for the year ended 31 December 2019 (continued)

12 Stocks

	2019 £'000	2018 £'000
Raw materials	**2,621**	1,800
Work in progress	**53**	-
Finished goods	**596**	-
	3,270	1,800

Inventories are stated after provisions for impairment of £640,000 (2018: £124,000).

13 Debtors

	2019 £'000	2018 £'000
Trade debtors	**300**	331
Amounts owed by group companies	**2,017**	-
Preference Shares - associates	**154**	309
Other debtors	**98**	507
Prepayments and accrued income	**424**	312
Deferred tax asset	**3,964**	3,089
	6,957	4,548

Included within amounts stated above are the following amounts falling due after more than one year:

	2019 £'000	2018 £'000
Other debtors	**78**	-
Preference Shares	**154**	309
Deferred tax asset	**3,725**	3,089
	3,957	3,398

The preference share debt of £154,000 (2018: £309,000) falls due after more than one year and is stated after provision for impairment of £161,000 (2018: £nil).

Amounts due from group undertakings are unsecured, interest free and carry no fixed term of repayment.

Trade debtors are stated after provisions for impairment of £4,000 (2018: £nil).

Notes to the financial statements for the year ended 31 December 2019 (continued)

14 Creditors – Amounts falling due within one year

	2019	2018
	£'000	£'000
Bank overdrafts	**1,149**	-
Trade creditors	**193**	9,055
Amounts owed to group undertakings	**690**	768
Taxation and social security	**50**	42
Other creditors	**19**	-
Accruals and deferred income	**6,648**	4,159
	8,749	14,024

Amounts due to group undertakings are unsecured, interest free and carry no fixed term of repayment.

15 Creditors – Amounts falling due after more than one year

	2019	2018
	£'000	£'000
Loan due to parent Company	**31,034**	35,645
Bank loan	**24,883**	-
	55,917	35,645

The loan from parent Company does not fall due for repayment within one year, and has no specified repayment date beyond this period. This loan is unsecured and bears interest at 5%.

On the 29 August 2019 the company agreed a new £30m Asset Finance facility provided by HSBC Bank Plc that is secured over various plant and machinery. The facility has a five-year term and an interest rate margin of 1.65% per annum over the base rate of any drawn balances.

Bank loan balance can be analysed as follows:

	2019	2018
	£'000	£'000
Payments due		
Not later than one year	**2,083**	-
Later than one year not later than five years	**22,800**	-
Due after five years	-	-
	24,883	-

Notes to the financial statements for the year ended 31 December 2019 (continued)

16 Financial instruments

	2019	2018
	£'000	£'000
Financial assets:		
Financial assets that are debt instruments measured at amortised cost	**2,569**	1,149
Financial liabilities:		
Financial liabilities measured at amortised cost	**64,616**	49,627

Financial assets measured at amortised cost comprise cash at bank and in hand, trade debtors, amounts owed by group undertakings and preference shares held in associate and other debtors.

Financial liabilities measured at amortised cost comprise trade creditors, amounts owed to group undertakings, bank loans, other creditors and accruals and deferred income.

Notes to the financial statements for the year ended 31 December 2019 (continued)

17 Called up share capital

	2019	2018
	£	£
Authorised		
100,000 (2018:100,000) ordinary shares of £1 each	**100,000**	100,000
Allotted, called-up and fully paid		
2 (2018: 2) ordinary shares of £1 each	**2,000**	2,000

18 Profit and loss account

	2019	2018
	£'000	£'000
At 1 January	**(3,982)**	(521)
Loss for the financial year	**(2,257)**	(3,497)
Share based payment costs transferred to other reserves	**48**	36
At 31 December	**(6,191)**	(3,982)

19 Operating lease commitments

	2019	2018
	£'000	£'000
Payments due		
Not later than one year	**1,310**	1,538
Later than one year not later than five	**12,403**	11,706
Due after five years	**13,474**	18,116
	27,187	31,360

Notes to the financial statements for the year ended 31 December 2019 (continued)

20 Capital commitments

The company had capital commitments at 31 December 2019 of £nil (2018: £3,405,279) primarily relating to plant and equipment purchased for the new foundry at Newport, United Kingdom.

21 Contingencies

On 24 January 2019 the company entered into a new cross guarantee with other group companies to guarantee the group indebtedness to the Group's primary bankers. This guarantee is supported by a fixed and floating charge over the assets and undertakings of the company.

22 Share based payments

Certain employees of the company along with other group employees have been granted long term incentive awards and options over the shares in IQE plc.

Long Term Incentive Awards
Long-term incentive awards become exercisable between three and five years from the date of grant subject to continued employment and the achievement of performance conditions relating to growth in earnings per share targets over a three-year vesting period that cannot be extended. The Group has no legal or constructive obligation to repurchase or settle the options in cash.

Share Options
Share options are granted with a contractual life of ten years with a fixed exercise price equal to the market value of the shares under option at the date of grant. Options become exercisable between one and ten years from the date of grant subject to continued employment and the achievement of performance conditions, including growth in EBITDA and earnings per share against various targets.

The company recognises an equity-settled share-based payment expense based on a reasonable allocation of the total charge for the group in respect of long-term incentive and share option awards. This allocation is the total charge for the group prorated for the number of participating employees of the company.

Notes to the financial statements for the year ended 31 December 2019 (continued)

23 Related Party Transactions

Compound Semiconductor Centre Limited was established by the IQE plc group and its joint venture partner as a centre of excellence for the development and commercialisation of advanced compound semiconductor wafer products in Europe. On its formation the IQE plc group contributed assets to the joint venture valued at £12,000,000, transferred employees and licensed intellectual property to establish the CSCL's manufacturing and technical capability whilst at the same time entering into an agreement with CSCL that conveys to the Company the right to use the assets of the CSCL for a minimum five-year period following formation of the joint venture (see note 2). Cardiff University contributed cash.

The commercial purpose of the CSCL is the research, development and manufacture by MOCVD of advanced compound semiconductor materials in Europe. The business was set-up by the joint venture partners to provide a bridge between early stage research and high-volume manufacturing and was established in a manner to provide the CSCL with the capability to deliver specialist compound semiconductor product development, prototyping and early stage manufacturing services to academic and industrial customers from its own compound semiconductor foundry.

CSCL operates from its manufacturing facilities in Cardiff, United Kingdom and procures certain administrative support services from the IQE plc group. As part of the administrative support services provided to CSCL the Company procured goods and services, recharged to CSCL at cost, totalling £1,132,000 (2018: £902,000).

CSCL granted the Company the right to use its assets following its formation for a minimum five-year period. Costs associated with the right to use the CSCL's assets are treated by the Company as operating lease costs (see note 2) and are charged by the CSC at a price which reflects the CSCL's cash cost of production (including direct labour, materials and site costs) but excludes any related depreciation or amortisation of the CSCL's property, plant and equipment and intangible assets. Costs associated with the right to use the CSCL's assets totalled £1,532,000 (2018: £1,215,000) in the year.

At 31 December 2019 an amount of £9,000 (2018: £93,000 owed from) was owed from the CSCL.

In the Company's year-end balance sheet 'A' Preference Shares with a nominal value of £338,000 (2018: £338,000) are included in financial assets at an amortised cost of £154,000 (2018: £309,000).

24 Pension commitments

The Company operates a defined contribution pension scheme covering all of its employees, but excluding non-executive directors. Contributions of £132,000 (2018: £94,000) were charged to the profit and loss account in the year in which they were payable. The balance owed to the pension providers at 31 December 2019 is £nil (2018: £nil). All commitments under the pension scheme in respect of the employer's contributions have been met during the year.

25 Parent company and ultimate controlling party

The ultimate parent company and controlling party is IQE Plc, whose consolidated financial statements are available from the Company Secretary, Beech House, Pascal Close, St Mellons, Cardiff, CF3 0LW. This is the smallest and largest group in which the results of the Company are included.

IQE Plc is incorporated in England and Wales.