MODERNWATER







MODERN WATER PLC

Annual Report and Accounts 2009

CORPORATE STATEMENT

MODERN WATER WAS ESTABLISHED TO BUILD AND EXPLOIT A PORTFOLIO OF WATER TECHNOLOGIES TO ADDRESS PROBLEMS OF THE AVAILABILITY OF FRESH WATER AND THE TREATMENT AND DISPOSAL OF WASTEWATER. BY 2025, IT IS FORECAST THAT TWO THIRDS OF THE WORLD'S POPULATION WILL LIVE IN COUNTRIES CLASSIFIED AS WATER-STRESSED. CLIMATE CHANGE IS LIKELY TO FURTHER EXACERBATE THIS SITUATION.

MANAGED BY AN EXECUTIVE TEAM WITH IMPRESSIVE EXPERIENCE IN THE WATER INDUSTRY, MODERN WATER IS AT THE LEADING EDGE OF NEW AND IMPORTANT TECHNOLOGY, WHICH IS VITAL TO THE FUTURE SUSTAINABILITY OF THE WORLD'S MOST PRECIOUS COMMODITY.

HIGHLIGHTS

Winner of the AIM Sustainability Award 2009

OPERATIONAL

Agreement with Oman based Omzest to assist market development

Building on success in Gibraltar, Oman desalination plant operating ahead of expectations

Evaporative cooling system proving plant to be installed in Oman by mid-2010

FINANCIAL

Cymtox achieves first revenue; further proof of commercialisation

Patent portfolio significantly increased

Balance of shares acquired in Cymtox Ltd

Strong financial position with £23.1 million cash and no debt

AT A GLANCE

THE STORY SO FAR

2007

- Successful IPO completed in June 2007, raising £30 million.
- Moved into new office head quarters in Guildford during the autumn.
- Completed migration of all administrative processes and financial functions from founding shareholder.
- Business Development team established, and identification of first MO desalination application underway.

2008

- Gibraltar proving plant is commissioned and produces first water in September.
- Following opening of office in Oman to tap into key Middle East market, an agreement to develop new commercial plant in Al Khaluf, near Muscat, is signed.
- Winner of the Energy/ Environmental award at the first pan-European Academic Enterprise ACES Awards held at the Royal Academy of Engineering in Stockholm in December 2008.
- Investment made in AguaCure Limited, a UK-based company specialising in proven electrochemical water treatment technologies.

THE WORLD'S WATER CRISIS

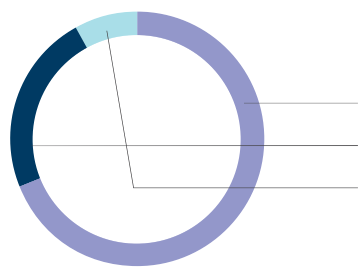
Fresh water is a finite resource and, as water consumption and population increase, many parts of the world are experiencing the effects of reduced water availability.

Annual water consumption around the world has risen sixfold during the past century, which is more than twice the rate of population growth. Demand is forecast to continue to grow and by 2025, five and a half billion people, two-thirds of the world's population, will live in countries that are water-stressed. In recognition of the growing water crisis, the United Nations General Assembly proclaimed the years 2005 to 2015 the International Decade for Action 'Water for Life'.

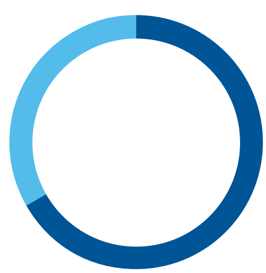
In addition, whilst the future impact of climate change remains uncertain, there is a consensus amongst the scientific community that it is likely to exacerbate the water crisis through an increase in extreme weather events such as droughts and flooding.

Growing population, changing diet and increasing production of bio-fuels will put significant pressure on depleted water resources with implications for global security, health and lifespan.

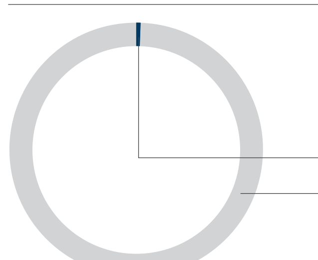
GLOBAL WATER USE



BY 2025, TWO-THIRDS OF THE WORLD'S POPULATION WILL LIVE IN WATER-STRESSED COUNTRIES



0.76% OF THE WATER ON EARTH IS AVAILABLE FOR CONSUMPTION



Source: United Nations Environment Programme (UNEP)

2009

Gibraltar proving plant demonstrates energy and cost savings compared with traditional methods.

Oman commercial desalination plant is operational.

Winner of the AIM 'Achievement in Sustainability' Award in November.

First revenues are delivered by Cymtox in November, following which the remaining shares in the Company are acquired in December.

For information on operational progress go to the Business review on pages 06 to 09.

PROVIDING THE SOLUTION

Modern Water's strategy is to promote the success of the business for the benefit of its shareholders by identifying, developing and implementing technologies that transform under-performing water assets into industry-leading projects.

MO DESALINATION

- Membrane desalination
- Evaporative cooling systems
- Pre-treatment for thermal desalination plants

30%

Our Gibraltar proving plant demonstrates energy savings of 30% compared with traditional methods

For information on our operations in Oman and Gibraltar see page 06

INDUSTRIAL APPLICATIONS

- Toxicity monitoring (Cymtox)
- Chemical free electro coagulation (AguaCure)
- Secondary oil recovery

100%

Cymtox now wholly owned with remaining shares acquired in December 2009

For information on Cymtox Limited see page 07

WASTEWATER

- Seawater substitution (PWL)

30%

We are the owner of leading technology for the use and treatment of seawater for toilet flushing, thereby reducing the domestic requirement for fresh water by over 30%

For updated progress on our wastewater activities see page 07

FUTURE DEVELOPMENTS

- Hydro Osmotic Power (HOP)

140%

The global desalination industry is predicted to grow 140% between 2005 and 2015

GWI Global Industry Forecast

For updated progress on our HOP technology see page 07

$56.4bn

Capital expenditure on desalination worldwide is expected to total $56.4 billion by the end of 2015

GWI Global Industry Forecast

For information on our finances see page 09

CHAIRMAN'S STATEMENT

"Modern Water is financially robust, with first revenues generated and significant progress made in the deployment and commercialisation of our technology."

I am pleased to report to our shareholders that in 2009 Modern Water successfully moved from the development stage into commercialisation of our core technologies. A number of major milestones were reached, including first revenue generation, and we now look ahead to building on those achievements to deliver further success across the business in 2010.

SIGNIFICANT TECHNICAL AND COMMERCIAL PROGRESS

In 2009, Modern Water made significant progress in the commercialisation and deployment of our platform Manipulated Osmosis Desalination (MOD) technology. Our plants in Gibraltar and Oman are the only two in the world to successfully produce water using the forward osmosis process. The performance of our Gibraltar plant continues to exceed our expectations, and proves that the technology can deliver significant cost and energy savings. Our experience in Gibraltar has been essential to the success of our larger plant in Oman which is producing extremely positive results. This confirms that the achievements in Gibraltar can be replicated in the more challenging conditions in the Middle East.

Additional progress has been made with the deployment of our platform MOD technology in our first evaporative cooling system proving plant. This will be installed in Oman by mid-2010.

We also achieved a major milestone by generating the first revenue from sales of our online water toxicity monitor, the Cymtox CTM™, in China at the end of 2009. During 2009, Modern Water purchased the remaining shares in Cymtox Limited and we also increased our investment in the water purification company AguaCure Limited in February 2010. This will ensure that we are able to maximise our benefit from the commercialisation of these technologies. Trials for AguaCure's proprietary chemical free electro coagulation technology are ongoing in both the motor and water industries and those trials are generating positive results.

FINANCIALLY STRONG WITH PRUDENT APPROACH

Despite ongoing challenges within global financial markets, Modern Water remains financially robust with £23.1 million of cash (2008: £26.8m) and no debt. As we expand, the

Group remains committed to maintaining a prudent approach to expenditure, providing value to our shareholders.

STRONG MOMENTUM IN ONE OF OUR KEY MARKETS

Investment in desalination in the Middle East is set to grow significantly over the next 10 years and is therefore a key market for Modern Water. To further our operations in the region, the Group has signed an agreement with Omzest, an Oman-based industrial group, to represent and market Modern Water's technologies within the Sultanate and at targeted locations elsewhere in the region.

CONTINUED INVESTMENT IN RESEARCH AND DEVELOPMENT

The Group continues to invest in important research and development work to maintain our strong market position. We have made a significant investment in our patent portfolio, more than doubling the number of patents filed in the past year, to secure our intellectual property for future commercialisation. This adds value to all of our technologies, increases market opportunities and in turn minimises risk for our shareholders.

SUSTAINABILITY AT THE HEART OF OUR BUSINESS

Sustainability is at the heart of our operations and underpins all of the Group's activities. We were therefore delighted to accept the AIM Achievement in Sustainability award in November 2009. Modern Water has been nominated for this award in each of the past two years, and last year's victory recognises our dedication and lasting commitment to sustainability.

OVERVIEW

The Group starts 2010 in an excellent position. Modern Water is financially robust, with first revenues generated and significant progress made in the deployment and commercialisation of our technology. The Group looks forward to building on our success over the coming year.

On behalf of the Board I would like to thank the Modern Water team, and our partners in the UK and around the world. Their ongoing commitment and hard work is fundamental to the continued success of Modern Water.

N. McDougall

NEIL MCDOUGALL
Executive Chairman
10 March 2010

BUSINESS REVIEW

The last year has seen Modern Water achieve a number of important milestones in the commercialisation and deployment of our technology portfolio. The desalination proving plant in Gibraltar exceeded operational expectations, while the larger commercial plant in Oman began successful production of water. First revenues were generated from sales of the Cymtox Continuous Toxicity Monitor (CTM™) and the Group invested significantly in further patents to secure our intellectual property.

MANIPULATED OSMOSIS

Membrane desalination

In May 2009 our Manipulated Osmosis Desalination (MOD) plant, the world's first, began supplying water into Gibraltar's local distribution system. The plant continues to operate beyond original expectations, and results prove the significant benefits achieved from our process. Substantially lower operating costs are achieved by reducing energy use and chemical consumption. This provides a more environmentally friendly alternative to traditional desalination methods. Further savings have been achieved, including confirmation of significantly lower levels of boron without additional treatment.

The results of the development work carried out in Gibraltar has improved the design and enhanced the performance of our larger plant in Oman. The ongoing six-month trial in Oman is producing extremely positive results. The technology delivers similar savings and operational benefits to those achieved in Gibraltar, even in the more environmentally challenging conditions experienced in the Gulf region. The Oman plant operates alongside an existing desalination plant allowing us to demonstrate the superior performance of our technology. Further results will be announced when the trial period has been completed.

Our proprietary Manipulated Osmosis process is a platform technology which can be applied across a number of industries to deliver impressive results. Applications include evaporative cooling systems, pre-treatment for thermal desalination plants, secondary oil recovery and Hydro Osmotic Power.

Evaporative cooling systems

The evaporative cooling system proving plant has now been fabricated and is scheduled to be installed in Oman by mid-2010. Applying the

"The Group seeks patent protection for our own ideas arising from our research, development and commercialisation activities. The protection and exploitation of intellectual property is fundamental to our success."

Group's platform MO technology, it works by using water from non-potable sources such as seawater to supply make-up water to the evaporative cooling process. In this way it displaces the use of other water sources, such as desalinated water or treated potable water. The process uses a fraction of the electricity of a conventional reverse osmosis desalination plant to provide the same quantity of water. It therefore has the potential to extend the use of evaporative cooling as a more sustainable and cost effective alternative to other systems.

Pre-treatment for thermal desalination plants

Initial design work has been completed and the Group is currently undertaking an analysis of potential locations to test its pre-treatment application for thermal desalination plants. The method, which uses Modern Water's platform Manipulated Osmosis process, increases the top temperature of the plant, thereby increasing output by up to 25%. The technology also reduces costly chemical dosing requirements and has the added benefit of extending the life span of desalination plants. Furthermore, the process reduces the problem of pollutants in the brine output, and can be applied to existing or new plants as required.

Hydro Osmotic Power (HOP)

The Group's patented HOP technology generates renewable energy by mixing water with different levels of salinity. A proving plant design has been completed and plans to deploy the plant are currently underway.

INDUSTRIAL APPLICATIONS

Cymtox Limited

In December 2009, Cymtox Limited (Cymtox) became a wholly owned subsidiary of Modern Water, when the Group purchased the remaining shares in Cymtox. This allows the Group to reap the full benefit of existing and future sales of the leading Continuous Toxicity Monitor (CTM™) units. During the reporting period, first sales of the technology were secured in China. Modern Water is now focused on developing additional markets where we have received very strong interest.

Ongoing research and development are fundamental to the success of our technologies. This is demonstrated by the recent grant approval from EPSRC (Engineering and Physical Sciences Research Council) for a 12-month collaboration agreement between Cymtox and Leeds University covering the development of a low-cost solid state toxicity sensor. The Group has secured a worldwide exclusive license to the intellectual property for this technology and will spend the coming year incorporating this research into our existing product range in order to further enhance our offering.

AguaCure Limited

On 5 February 2010 the Group invested an additional £100,000 in AguaCure Limited (AguaCure), increasing the Group's shareholding to 54%. This comes at a time when AguaCure is conducting a trial with Southern Water of its proprietary chemical free electro-coagulation technology to remove contaminants from water. An agreement to undertake a similar trial with Severn Trent Water has been confirmed and will commence in the spring of 2010. Trials are also taking place in the motor industry.

WASTEWATER

The Group has patented technology that allows seawater to be used for toilet flushing by treating the resulting

effluent to European discharge standards, thereby reducing the domestic requirement for fresh water by up to 30%. Field tests of the technology have been successfully completed and design work was finalised during the reporting period. Commercial opportunities are currently being considered.

MARKET

There is no doubt that the global water market is growing year on year, as water scarcity continues to be an increasingly urgent issue for many parts of the world. The Group has identified the Middle East as a key market with expectations that annual capital and operating expenditure on water and wastewater across the region will rise from US$31 billion (£19 billion) in 2009 to US$52.3 billion (£32 billion) in 2016 (Global Water Intelligence). To this end, the Group has signed an agreement with Middle East specialists, Omzest, to represent the interests of Modern Water in Oman and further afield in the region.

INTELLECTUAL PROPERTY

The Group has a clear and measured strategy regarding our approach to enhancing and securing further intellectual property. The Group seeks patent protection for our own ideas arising from our research, development and commercialisation activities, and looks to acquire third party patent and know-how rights to support our activities and goals. The Group also monitors competitor activity and strives for technological advantage in order to fill gaps in the market. At listing in 2007 on the Alternative Investment Market (AIM), the Group's patent portfolio was primarily based on five desalination patent families. Since then a further six patent applications have been filed covering the Group's core MOD technology and other portfolio-related technologies. The protection and exploitation of intellectual property is fundamental to our success.

RESOURCES

We have continued to grow our core team in response to the increasing deployment of technologies. The Group now has 25 permanent staff and hires additional staff on a contract basis. The technical team has doubled in size, including recruitment of a number of graduate engineers. We remain committed to developing our staff through focused training and development both on the job and through external courses.

RISKS AND UNCERTAINTIES

The risks inherent in the operation of the Group are well understood. Control measures have been established to ensure that these risks are adequately controlled both in terms of frequency and consequences. Risks and internal control measures are described in more detail in the Corporate Governance Statement.

FINANCIAL REVIEW

Summary

The financial position of the Group is strong, with £23.1m cash in the bank and no debt at 31 December 2009 (2008: £26.8m net cash). The Group generated its first revenue of £0.1m (2008: £nil). The Group's loss increased to £3.6m (2008: £2.4m), primarily due to a decline in finance income, as the yields available on term deposits reduced, and increased investment in the technical team and pilot plants.

Accounting policies

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

Capital structure

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

Treasury management

The Group has adopted a low risk approach to treasury management. Cash balances are invested in fixed interest term deposit accounts, with maturity dates to suit projected liquidity requirements. Credit risk is addressed by the Group's treasury policy (see note 3 to the accounts). Deposits are selected based on achieving the optimum balance of yield, security and liquidity.

Cash flows

The Group cash outflow for the year was £3.7m (2008: £2.3m). The major cash inflow was £0.9m interest on term deposits (2008: £1.7m). Cash outflows comprised £0.5m plant and equipment (2008: £0.5m), £0.1m patents (2008: £0.1m), £0.3m net cash invested in subsidiaries and joint ventures (2008: £0.3m) and £3.7m operating costs (2008: £3.0m).

CONCLUSION

Modern Water was established to build and exploit a portfolio of water technologies to address the problems of fresh water availability and the treatment and disposal of wastewater. During the reporting period the Group proved its capability to achieve these objectives with the successful deployment of our core technologies. First revenues were generated and further investment was made in enhancing our intellectual property portfolio. The executive team look forward with confidence to continuing this success over the coming year.

SIMON HUMPHREY
Chief Executive Officer
10 March 2010

CORPORATE AND SOCIAL RESPONSIBILITY

A key focus of our research is to reduce the environmental impact of water treatment globally

We are committed to the improvement and sustainability of the environment in which we operate

"Modern Water continues to work to make a difference at all levels in the community, both in terms of global sustainability and the local communities in which the Group operates."

The Group's continued commitment to our corporate and social responsibility was rewarded in 2009, when we were named the winner of the Achievement in Sustainability award at the AIM Awards in November 2009. The Group was recognised by the voting panel for its efforts in economic, environmental and social sustainability. It is the second successive year that Modern Water has been nominated at the event, which is organised by the London Stock Exchange. The voting panel made their decision based on proof of leadership, innovation and lasting commitment to sustainability, and the prize fully recognises the values at the heart of Modern Water. Environmental responsibility and sustainable behaviour will always be at the core of our business.

In September 2009, we linked up with the British Science Association as a sponsor of the British Science Festival, which was hosted this year by the University of Surrey. As one of the Festival sponsors, we exhibited at the 'Science about Town' event in Guildford town centre. Visitors to the Modern Water stand were able to see first hand how the Group's technology works, and we conducted fun and educational experiments for children

and adults alike. Through sponsorship of the event, we were particularly keen to spark enthusiasm and excitement in young people to consider science or engineering as a career.

When we discovered the British Science Festival was coming to Guildford in 2009, it was a clear opportunity to lend support and encourage an interest and delight in science from people living in the Surrey area where Modern Water's head office is located. The Group's application of science and technology in a commercial environment, along with close links with both the university and the town, delivered a perfect synergy with this informative, creative and innovative festival. To have the event hosted on our doorstep offered a fantastic opportunity for Modern Water to engage with our community.

As part of our ongoing commitment to the University for the Creative Arts (UCA), based in nearby Farnham, we became a corporate sponsor of the Fine Art Degree Show at the university in May 2009. This sponsorship took place in conjunction with our continuing exhibition of artwork produced by the students, who have transformed our head office with the addition of the paintings and photographs they have created. The arrangement offers students the opportunity to display their work in a unique environment.

Modern Water continues to work to make a difference at all levels in the community, both in terms of global sustainability and the local communities in which the Group operates. We remain committed to that effort in 2010.

SIMON HUMPHREY
Chief Executive Officer
10 March 2010

THE BOARD OF DIRECTORS

1) NEIL MCDOUGALL
Executive Chairman

Neil McDougall is a co-founder of the Company. As Executive Chairman, his main focus is to deliver value to the Company's shareholders by shaping Modern Water's growth strategy. He is also responsible for maintaining the Company's relationship with the City. Neil has extensive experience of the water industry at an international level.

2) SIMON HUMPHREY
Chief Executive Officer

Simon Humphrey is a co-founder of the Company and has been CEO since Modern Water's inception in December 2006. Simon oversees the day-to-day running of Modern Water, ensuring the Company and its investments progress successfully. He brings a host of water industry and capital investment experience to the role, and regularly visits Modern Water's international sites to ensure their smooth operation.

3) FRANCIS O'NEILL
Company Secretary

Since mid-2008 Francis has been responsible for group secretarial and legal matters in Modern Water and its subsidiaries, and also manages the intellectual property portfolio. He is a seasoned legal professional with broad experience in an international environment, including acquisitions and major project work in the industrial sector. His previous 18 years in a number of different roles with the BOC/Linde Group has given him strong commercial acumen coupled with strategic vision, and the ability to apply the law to practical advantage.

4) MICHAEL GRADON
Senior Independent Non-executive Director

Michael has over 25 years' experience in senior commercial, management and legal positions. He spent 20 years at P&O and was a main board director for eight years until its takeover in 2006 by Dubai Ports World. His roles included group commercial and legal director, Chairman of P&O's property business and Chief Executive Officer of its largest infrastructure project. He is a Non-executive Director of Exclusive Hotels, of Grosvenor Limited and of Genesis Lease Limited and a member of the committee of the All England Lawn Tennis Club and the Wimbledon Championships.

5) PAUL SHEPHERD
Non-executive Director

Paul is a chartered engineer with wide international experience in the construction and engineering industry. Until 2001, he was chairman and managing director of Shepherd Building Group, one of Europe's largest private companies. Activities covered construction, engineering, consulting, manufacturing, housing and property development.

6) TREVOR JONES
Non-executive Director

Trevor has considerable managerial experience in the water industry, as former chairman of Thames Water International. Trevor was Managing Director of Thames Water's UK business including the utility supplying water and waste water services to London and the Home Counties. He has extensive experience in the international water market including the Middle East, Asia, Latin America and Australia. Trevor is also a Non-executive Director of an NHS Strategic Health Authority.

7) MIKE TOWNEND
Non-executive Director

Mike is Director of Capital Markets at IP Group plc. He has 17 years experience in all aspects of equity capital markets and was formerly a managing director at Lehman Brothers. In this role, Mike focused particularly on hedge funds and alternative asset managers. He has extensive experience of raising capital, having recently completed a number of private company fundings.

CORPORATE GOVERNANCE STATEMENT

CORPORATE GOVERNANCE

As an AIM-listed company Modern Water plc is not required to issue a statement of compliance with the principles and provisions of the 2008 Combined Code on Corporate Governance ('the Combined Code'). However, the Board of Modern Water plc is committed to the principles of good corporate governance. This report, together with the information contained in the directors' remuneration report on pages 15 to 17, explains how the directors seek to apply the requirements of the Combined Code to the Group, where practical given its size, resources and stage of development.

BOARD OF DIRECTORS

The Board comprises the Executive Chairman (Neil McDougall), the Chief Executive Officer (Simon Humphrey) and four non-executive directors (Michael Gradon, Paul Shepherd, Trevor Jones and Mike Townend). Mike Townend is a representative of IP Group plc, the other three non-executive directors are independent.

The business and management of the Group and its subsidiaries are the collective responsibility of the Board. At each meeting, the Board considers and reviews the performance of each of the major projects. The Board has a formal written schedule of matters reserved for its review and approval. These include the approval of the annual budget, major capital expenditure, investment proposals, the interim and annual results, and a review of the overall system of internal control and risk management. There are two standing committees of the Board: Audit and Remuneration. Each of these committees acts within defined terms of reference. Additional information is set out later in this report and also in the directors' remuneration report in respect of the Remuneration Committee. In addition there is an Executive Committee whose purpose is to assist the Chief Executive Officer in the performance of his duties.

Authority for the execution of the approved policies, business plan and daily running of the business is delegated to the executive directors. Modern Water plc's Articles of Association require one third of the directors to stand for re-election each year at the Annual General Meeting. Accordingly, Michael Gradon and Mike Townend will retire and offer themselves for re-election at the forthcoming Annual General Meeting. All directors have access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures and applicable rules and regulations are observed. The Board has a procedure whereby any director may seek, through the office of the Company Secretary, independent professional advice, at the Group's expense, in furtherance of his duties. Formal agendas and reports are provided to the Board on a timely basis for Board and committee meetings and the Executive Chairman ensures that all directors are properly briefed on issues to be discussed at Board meetings. Directors are able to obtain further advice or seek clarity on issues raised at the meetings from within the Group or from external sources.

REMUNERATION COMMITTEE

Details of the committee and its policies are set out in the directors' remuneration report on pages 15 to 17.

The committee has formal terms of reference (available on request from the Company Secretary).

AUDIT COMMITTEE

The Audit Committee consists of Michael Gradon (Chairman, Audit Committee), Paul Shepherd, Trevor Jones and Mike Townend. The executive directors are not members of the committee but attend the meetings by invitation, as necessary, to facilitate its business.

The committee has formal terms of reference (approved on 19 September 2007 and available on request from the Company Secretary). These include the recommendation of the appointment, reappointment and removal of the external auditors, the review of the scope and results of the interim review and external annual audit by the auditors, their cost effectiveness, independence and objectivity. The committee also reviews the nature and extent of any non-audit services provided by the external auditors. In addition, the committee reviews the effectiveness of internal controls, considers the need for an internal audit function and considers any major accounting issues and reports on such matters to the Board. The committee reviews the integrity of the financial statements and formal announcements.

A whistle-blowing arrangement exists whereby matters can be confidentially reported to the committee. The Chief Executive Officer monitors the level and nature of non-audit services and specific assignments are flagged for approval by the Audit Committee as appropriate.

ATTENDANCE

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

	Board		Remuneration		Audit	
	Attended	**Eligible to attend**	**Attended**	**Eligible to attend**	**Attended**	**Eligible to attend**
Neil McDougall	8	8	—	—	—	—
Simon Humphrey	8	8	—	—	—	—
Michael Gradon	7	8	4	4	3	3
Paul Shepherd	8	8	4	4	3	3
Trevor Jones	7	8	3	4	2	3
Mike Townend	8	8	4	4	3	3

PRINCIPAL RISKS AND UNCERTAINTIES

The key risks and uncertainties affecting the Group are reviewed by the Board on a regular basis. The risks can be grouped into four main categories:

- financial risks, these are described in note 3 to the accounts;
- strategic risks, these include market acceptance of the Group's technologies, achieving the optimum corporate and capital structure and the allocation of resources to balance organic and acquisition growth;
- operational risks, these include the recruitment and retention of key personnel, health and safety risks and the security of Group assets, such as intellectual property and patents; and
- external risks, including competitor technology and overseas operations risks.

INTERNAL CONTROL

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

- reporting to the Board each month, including key financial information (statement of comprehensive income, statement of financial position and statement of cash flows) and the Chief Executive Officer's report on the business, significant changes and the external marketplace, including the extent to which they represent significant risk;
- detailed corporate policies and procedures document to address key operating and compliance risk areas, including procurement, treasury, human resources, health and safety. These are reviewed and updated at least annually;
- clear organisational structure with definite reporting lines and delegated authorities;
- centralised accounts team providing financial control and support to all Group companies; and
- an annual strategy review and an annual budget approved by the Board.

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

RELATIONS WITH SHAREHOLDERS AND INVESTORS

Copies of the Annual Report and Accounts are issued to all shareholders. Copies of the Annual Report and Accounts and the Interim Statement are available on the website: www.modernwater.co.uk. The Group makes full use of its website to provide information to shareholders and other interested parties. Shareholders are given the opportunity to raise questions at the Annual General Meeting and the directors are available both prior to and after the meeting for further discussion with shareholders. During the year, the Executive Chairman met with institutional investors at meetings arranged by the Group's brokers and financial PR advisers. Michael Gradon, as Senior Independent Non-executive Director, is available to shareholders where contact through the normal channels of Executive Chairman, Chief Executive Officer or Company Secretary are inappropriate or have failed to resolve concerns.

GOING CONCERN

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

DIRECTORS' REMUNERATION REPORT

REMUNERATION COMMITTEE

The Remuneration Committee comprises Michael Gradon (Chairman, Remuneration Committee), Paul Shepherd, Trevor Jones and Mike Townend.

The committee determines, in accordance with the terms of reference agreed on 6 June 2007, the remuneration and other benefits, including bonuses and share-based payments, of the executive directors.

The committee consulted with the executive directors about its remuneration proposals for the year.

REMUNERATION POLICY

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

SERVICE CONTRACTS

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

Non-executive directors have letters of appointment. Appointments can be terminated by the Group or the individual giving one month's notice. The services of Mike Townend are covered in a services agreement with IP Group plc, a major shareholder in the Company.

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

	Date of contract	Notice period (months)
Executive directors		
Neil McDougall	18 May 2007	12
Simon Humphrey	18 May 2007	12
Non-executive Directors		
Michael Gradon (Chairman)	14 March 2007	1
Paul Shepherd	14 March 2007	1
Trevor Jones	3 April 2007	1
Mike Townend	18 May 2007	1

Biographical details of all directors can be found on page 12.

DIRECTORS' REMUNERATION REPORT
CONTINUED

DIRECTORS' REMUNERATION

Remuneration for the executive directors comprises basic salary, annual bonus, pension, share-based payments and insurance cover for medical, life and income protection. The bonus payable is determined by performance against objectives, approved by the Remuneration Committee, which are set at the beginning of each year.

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

Remuneration for the directors during the year was as follows:

	Basic salary, allowances and fees £000	*Bonus £000	Pension £000	Benefits £000	Year ended 31 December 2009 Total £000	Year ended 31 December 2008 ** As disclosed in 2008 Annual Report Total £000	Year ended 31 December 2008 *** Annual bonus restated Total £000
Executive directors							
Neil McDougall	250	100	25	8	**383**	375	295
Simon Humphrey	125	50	13	3	**191**	188	151
Gerald Jones	—	—	—	—	**—**	33	33
Non-executive Directors							
Michael Gradon	35	—	—	—	**35**	35	35
Paul Shepherd	20	—	—	—	**20**	20	20
Trevor Jones	20	—	—	—	**20**	20	20
Mike Townend ****	—	—	—	—	**—**	—	—
	450	150	38	11	**649**	671	554

* Bonuses disclosed in 2009 directors' remuneration in the table above are for 2009 annual performance. These have been approved by the Remuneration Committee and are payable in cash in 2010.

** Directors' remuneration as disclosed in the 2008 Annual Report included bonuses for 2007 performance, but did not include bonuses for 2008 performance. The 2007 bonuses were approved by the Remuneration Committee after completion of the 2007 Annual Report and were therefore included in the 2008 rather than 2007 directors' remuneration report. Bonuses for 2008 performance had not been approved at the time of the 2008 Annual Report and were therefore not included in the 2008 directors' remuneration report.

*** Directors' remuneration in 2008 has been restated to include 2008 performance bonuses and exclude 2007 performance bonuses. Performance bonuses for 2008 were paid in cash in 2009 to Neil McDougall (£20,000) and Simon Humphrey (£12,500).

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

MODERN WATER INCENTIVE PLAN ('MWIP')

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

The Modern Water plc closing share price was 84.5p on 31 December 2009. The share price high for 2009 was 89p and the low was 28.5p.

A) OPTIONS

The executive directors were granted options over shares to vest in three tranches between 2008 and 2010. Holdings of options over ordinary shares issued under the MWIP were as follows:

	Grant date	Vesting date	At 1.1.09 number	Vested number	Issued number	Lapsed number	At 31.12.09 number	Option price	Charge to income statement in year
Neil McDougall	6.6.07	12.6.10	373,918	—	—	186,959	186,959	£1.19	£37,392
Simon Humphrey	6.6.07	12.6.10	747,836	—	—	373,918	373,918	£1.19	£74,783

The performance criteria for the second third of the options were not met so these lapsed on 12 June 2009. The first third had lapsed on 12 June 2008, due to performance criteria not being met. Subject to satisfaction of the performance criteria the final third vests on 12 June 2010. Options lapse if unexercised by 12 June 2017.

Each tranche vests subject to total shareholder return (TSR) being at least 10% for the 12 months preceding the relevant tranche vesting date, see note 9.1(a) to the accounts.

B) CONDITIONAL SHARE AWARDS

The directors' participation in conditional share awards under MWIP is as follows:

	Award date	Vesting date	At 1.1.09 number	Vested number	Conditionally awarded in year	Lapsed	At 31.12.09 number	Share price at award date	Charge to income statement in year
Neil McDougall	10.9.09	10.9.12	—	—	250,000	—	250,000	£0.725	£8,333
Simon Humphrey	10.9.09	10.9.12	—	—	250,000	—	250,000	£0.725	£8,333

The extent to which the award will vest depends on the Group's share price on the vesting date. If the share price is £1.40 or more the award will vest in full, and if the share price is £1.00 or below, the award does not vest at all. If the share price is between £1.00 and £1.40 the award partially vests, on the basis of 2.5% of the award for each £0.01 above a share price of £1.00.

MANAGEMENT SHARE INCENTIVE SCHEME ('MSIS')

The MSIS is the equity incentive scheme which directors were invited to subscribe to between 1 December 2006 and 12 March 2007. No further invitations to subscribe will be made under the MSIS. There has been no activity on the MSIS scheme since the 2008 Annual Report and Accounts. Details of the shares held under this scheme are included in note 9.2.

On behalf of the Board

MICHAEL GRADON
Chairman, Remuneration Committee
10 March 2010

DIRECTORS' REPORT

The directors present their Annual Report together with the audited consolidated financial statements for the year ended 31 December 2009.

PRINCIPAL ACTIVITIES

The principal activities of the Group during the year were sourcing, developing and deploying technology-based solutions to meet the growing demand for the economic availability of fresh water and treatment of wastewater. The principal activities of the Company were to resource and fund the operating companies within the Group. The Company is incorporated by shares in England and Wales, and has no branches elsewhere.

REVIEW OF THE BUSINESS AND RESULTS

A detailed review of the business is set out in the Business review on pages 6 to 9. This includes comments on the financial performance and position of the Group. Information on the Group's principal risks, uncertainties and the internal control environment, including the content of reporting to the Board, is included in the corporate governance statement on pages 13 to 14.

At the Group's current stage of development, the directors consider that strategic and operational progress is best measured by achievement against technical and business development milestones, as reported in the Business review.

The key financial information reported to the Board during the year included: revenue £0.1m (2008: £nil); operating loss £4.3m (2008: £4.1m); total comprehensive loss £3.6m (2008: £2.4m) and the cash balance £23.1m (2008: £26.8m).

The Group statement of comprehensive income for the year is set out on page 22. The directors do not recommend the payment of a dividend (2008: £nil).

RESEARCH AND DEVELOPMENT

Activities in research and development (R&D) are discussed in the Business review. Expenditure recorded in the statement of comprehensive income for R&D during the year was £336,000 (2008: £268,000). Development expenditure capitalised during the year was £nil (2008: £74,000).

FUTURE DEVELOPMENTS

Future developments and prospects are set out in the Business review.

DIRECTORS' INTERESTS

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

	% of issued share capital	Number of ordinary shares of 0.25p
Neil McDougall	10.6	6,265,000
Simon Humphrey	3.1	1,812,000
Michael Gradon	0.9	546,518
Paul Shepherd	0.4	250,000
Trevor Jones	0.0	16,807
Mike Townend	1.0	*575,000

* On 14 May 2009 legal title to 575,000 shares held by IP2IPO Nominees Limited on behalf of the beneficial holder under a nominee agreement transferred to Mike Townend.

There have been no changes in the interests set out above between 31 December 2009 and 10 March 2010.

DIRECTORS' LIABILITY INSURANCE

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

STAFF POLICY

The Group's employment policies are designed to ensure that they meet the statutory, social and market practices in the United Kingdom where the Group operates. The Group's employees are regularly informed of the Group's financial position and the market conditions in which it operates. This is achieved through briefings to managers and staff. The training and career development of employees is an activity which is considered fundamental to the success of the Group.

Employment policies are also designed to provide equal opportunities irrespective of colour, ethnic or national origin, nationality, sex, religion and marital or disabled status.

The Group offers appropriate training and career development for disabled staff. If members of staff become disabled the Group continues employment wherever possible and arranges retraining.

The Group encourages involvement of employees in the Group's performance through the Modern Water Incentive Plan.

SUPPLIER PAYMENT POLICY

It is the Group's policy to abide by the terms of payment agreed with suppliers in respect of the goods and services invoiced to the Group. Based on the calculation method defined in Statutory Instrument 2008/410 Schedule 7 paragraph 12, at 31 December 2009 the Group had an average of 25 days (2008: 22 days) purchases outstanding in creditors (Company: 84 days, 2008: 21 days).

POLITICAL AND CHARITABLE DONATIONS

The Group made no political and charitable donations during the year or prior year.

FINANCIAL INSTRUMENTS

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

PURCHASE OF OWN SHARES

There has been no purchase of own shares during 2009. On 12 December 2008 the Group, through Modern Water (Nominees) Limited, purchased 71,311 of the Company's ordinary 25p shares, representing 0.1% of the Company's share capital, for a consideration of £35,000 in preparation for awards due to staff under the bonus scheme. On 15 December 2008, 18,994 shares were awarded to an employee under the scheme.

POST BALANCE SHEET EVENTS

At 31 December 2009 Modern Water plc owned 45% of AguaCure Limited (AguaCure), which it accounted for as a joint venture. On 5 February 2010 Modern Water plc invested £100,000 for 20 newly issued AguaCure shares. This increased the Group's shareholding in AguaCure to 54%.

ANNUAL GENERAL MEETING

The Annual General Meeting will be held at the offices of Modern Water plc on 20 April 2010 at 10.00am. The notice convening the Annual General Meeting is set out on pages 47 to 50 of the Annual Report.

INDEPENDENT AUDITORS

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the Annual General Meeting.

DIRECTORS' STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

The directors who were members of the Board at the time of approving the directors' report are listed on page 12. Having made enquiries of fellow directors, each of these directors confirms that:

- to the best of each director's knowledge and belief, there is no relevant audit information of which the Group's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information.

By order of the Board

FRANCIS O'NEILL
Company Secretary
10 March 2010

STATEMENT OF DIRECTORS' RESPONSIBILITIES
IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

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

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group 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 the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

FRANCIS O'NEILL
Company Secretary
10 March 2010

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF MODERN WATER PLC

We have audited the Group and parent company financial statements (the 'financial statements') of Modern Water plc for the year ended 31 December 2009 which comprise the Group Statement of Comprehensive Income, the Group and Company Statements of Financial Position, the Group and Company Statements of Changes in Equity, the Group and Company Statements of Cash Flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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 the financial statements in accordance with applicable law |and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown, or into whose hands it may come save where expressly agreed by our prior consent in writing.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

OPINION ON FINANCIAL STATEMENTS

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2009 and of the Group's loss and Group's and parent company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the 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.

Rosemary Shapland

ROSEMARY SHAPLAND (SENIOR STATUTORY AUDITOR)
FOR AND ON BEHALF OF PRICEWATERHOUSECOOPERS LLP
Chartered Accountants and Statutory Auditors
Gatwick
10 March 2010

GROUP STATEMENT OF COMPREHENSIVE INCOME
YEAR ENDED 31 DECEMBER 2009

	Note	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Revenue	5	56	—
Cost of sales		(21)	—
Gross profit		35	—
Administrative expenses	7	(4,380)	(4,110)
Other income	5	6	—
Operating loss		(4,339)	(4,110)
Finance income	11	849	1,722
Finance costs	11	(21)	—
Share of loss of joint ventures	16	(145)	(9)
Share of loss of associates	16	—	(35)
Loss on ordinary activities before taxation		(3,656)	(2,432)
Taxation	12.1	29	27
Loss and total comprehensive loss for the year		(3,627)	(2,405)
Attributable to:			
Equity holders of the Company		(3,547)	(2,176)
Minority interest		(80)	(229)
		(3,627)	(2,405)

Loss per share for the year (attributable to equity holders of the Company)			
Basic loss per share	13.1	6.03p	3.70p
Diluted loss per share	13.2	6.03p	3.70p

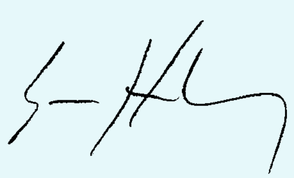
Items in the statement above are all derived from continuing operations.

Modern Water plc has taken advantage of the exemption provided under section 408 of the Companies Act 2006 not to disclose the Company statement of comprehensive income. The loss attributed to the Company in the year was £258,000 (2008: profit of £284,000).

GROUP AND COMPANY STATEMENTS OF FINANCIAL POSITION
AS AT 31 DECEMBER 2009

		Group		Company	
	Note	2009 £000	2008 £000	2009 £000	2008 £000
Assets					
Non-current assets					
Property, plant and equipment	14	1,148	779	—	—
Intangible assets	15	14,412	14,135	—	—
Investments	16	246	481	15,665	14,736
		15,806	15,395	15,665	14,736
Current assets					
Trade and other receivables	17	557	518	5,815	3,021
Cash and cash equivalents	18.1	23,123	26,855	23,056	26,779
		23,680	27,373	28,871	29,800
Total assets		39,486	42,768	44,536	44,536
Equity and liabilities					
Equity					
Called up share capital	23	147	147	147	147
Share premium account		30,532	30,532	30,532	30,532
Merger reserve		12,782	12,782	12,782	12,782
Retained earnings		(5,394)	(2,105)	788	783
		38,067	41,356	44,249	44,244
Minority interest		14	34	—	—
Total equity		38,081	41,390	44,249	44,244
Liabilities					
Non-current liabilities					
Deferred tax liability	12.3	390	419	—	—
Current liabilities					
Trade and other payables	19	1,015	951	287	292
Borrowings	20	—	8	—	—
		1,015	959	287	292
Total liabilities		1,405	1,378	287	292
Total equity and liabilities		39,486	42,768	44,536	44,536

The financial statements on pages 22 to 46 were approved by the Board of directors on 10 March 2010 and signed on its behalf by:



SIMON HUMPHREY
Chief Executive Officer
10 March 2010
Modern Water plc
Registered in England and Wales Number 5963927

GROUP AND COMPANY STATEMENTS OF CHANGES IN EQUITY
YEAR ENDED 31 DECEMBER 2009

Group	Note	Called up share capital £000	Share premium account £000	Merger reserve £000	Retained earnings £000	Total £000	Minority interest £000	Total Equity £000
Year ended 31 December 2008								
Equity as at 1 January 2008		147	30,532	12,782	(380)	43,081	173	43,254
Acquisition of subsidiaries		—	—	—	—	—	90	90
Purchase of own shares	9.1(c)	—	—	—	(35)	(35)	—	(35)
Share-based payments	9	—	—	—	486	486	—	486
Loss and total comprehensive loss for year		—	—	—	(2,176)	(2,176)	(229)	(2,405)
Equity as at 31 December 2008		147	30,532	12,782	(2,105)	41,356	34	41,390
Year ended 31 December 2009								
Equity as at 1 January 2009		147	30,532	12,782	(2,105)	41,356	34	43,390
Transaction with minority interest	6	—	—	—	—	—	60	60
Cash-settled share-based payments	9.1(c)	—	—	—	(5)	(5)	—	(5)
Equity-settled share-based payments	9	—	—	—	263	263	—	263
Loss and total comprehensive loss for year		—	—	—	(3,547)	(3,547)	(80)	(3,627)
Equity as at 31 December 2009		**147**	**30,532**	**12,782**	**(5,394)**	**38,067**	**14**	**38,081**

Company	Note	Called up share capital £000	Share premium account £000	Merger reserve £000	Retained earnings £000	Total £000	Minority interest £000	Total Equity £000
Year ended 31 December 2008								
Equity as at 1 January 2008		147	30,532	12,782	13	43,474	—	43,474
Share-based payments	9	—	—	—	486	486	—	486
Profit and total comprehensive income for year		—	—	—	284	284	—	284
Equity as at 31 December 2008		147	30,532	12,782	783	44,244	—	44,244
Year ended 31 December 2009								
Equity as at 1 January 2009		147	30,532	12,782	783	44,244	—	44,244
Share-based payments	9	—	—	—	263	263	—	263
Loss and total comprehensive loss for year		—	—	—	(258)	(258)	—	(258)
Equity as at 31 December 2009		**147**	**30,532**	**12,782**	**788**	**44,249**	**—**	**44,249**

The merger reserve resulted from the acquisition of Surrey Aquatechnology Limited on 12 June 2007 and represents the fair value of equity-based consideration.

GROUP AND COMPANY STATEMENTS OF CASH FLOWS
YEAR ENDED 31 DECEMBER 2009

		Group		Company	
	Note	2009 £000	**2008 £000**	2009 £000	**2008 £000**
Cash flows from operating activities					
Cash used in operations	24	(3,648)	(3,007)	(3,692)	(3,043)
Net cash flows used in operating activities		(3,648)	(3,007)	(3,692)	(3,043)
Cash flows from investing activities					
Disposal of property, plant and equipment	14	—	—	—	103
Purchase of property, plant and equipment	14	(540)	(460)	—	—
Purchase of patents and development costs	15	(100)	(149)	—	—
Acquisition of subsidiaries, net of cash acquired	6, 16	(285)	66	(885)	(150)
Acquisition of joint venture	6, 16	—	(400)	—	(400)
Interest received		875	1,747	874	1,729
Net cash flows (used in)/generated from investing activities		(50)	804	(11)	1,282
Cash flows from financing activities					
Purchase of own shares	9.1(c)	—	(35)	—	—
Cash-settled share-based payments	9.1(c)	(5)	—	—	—
Repayment of borrowings	20	(8)	(24)	—	(15)
Net cash flows from financing activities		(13)	(59)	—	(15)
Net decrease in cash and cash equivalents		(3,711)	(2,262)	(3,703)	(1,776)
Cash and cash equivalents at the beginning of the year	18	26,855	29,059	26,779	28,497
Exchange (losses)/gains on bank balances		(21)	58	(20)	58
Cash and cash equivalents at the end of the year	18	23,123	26,855	23,056	26,779

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL INFORMATION

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

The consolidated and Company financial statements of Modern Water plc (the 'Company') and its subsidiaries (together the 'Group') for the year ended 31 December 2009 were authorised for issue by the Board of directors on 10 March 2010 and the statement of financial position was signed by the Chief Executive Officer (Simon Humphrey).

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies have been applied consistently throughout the year, unless otherwise stated, in the preparation of these financial statements.

2.1 Basis of preparation and changes in accounting policy and disclosures

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

(a) Standards, amendments and interpretations to existing standards effective in 2009

The following new standards and amendments to standards are mandatory for the first time for the financial year beginning 1 January 2009 and relevant to the Group:

- IAS 1 (Revised), 'Presentation of financial statements'. This has resulted in some changes to terminology, including revised titles, for presentation and disclosure of assets, liabilities, income and expenses in the financial statements. The Group has elected to present one performance statement (the statement of comprehensive income);
- IFRS 2 (Amendment), 'Share-based payment'. Restricts vesting conditions to service and performance conditions alone. This has no impact on these financial statements;
- IFRS 7 (Amendment), 'Financial instruments: Disclosures'. Requirement for enhanced disclosures about fair value measurement and liquidity risk. This has resulted in increased disclosure in these financial statements;
- IFRS 8, 'Operating segments'. This requires a 'management reporting' approach to segmental analysis and aligns reporting with requirements of US standard SFSA 131. The Group currently reports in one operating segment. This has resulted in increased disclosure in these financial statements;
- IAS 23 (2007), 'Borrowing costs', requires capitalisation of borrowing costs as part of the cost of the asset. This has no impact on these financial statements;
- IAS 39 (Amendment), 'Financial instruments: Recognition and measurement'. This has no impact on these financial statements; and
- IFRIC 16, 'Hedges of a net investment in a foreign operation'. This has no impact on these financial statements.

(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following new standards, amendments to standards and interpretations have been issued, but are not effective for the financial year beginning 1 January 2009 and have not been early adopted:

- IFRS 3 (Revised), Business Combinations and consequential amendments to IAS 27 'Consolidated and separate financial statements', IAS 28 'Investments in associates' and IAS 31 'Interests in Joint Ventures'. The revised standard continues to apply the acquisition method to business combinations, with some significant changes. Changes to measurement of the fair value of payments made to acquire a business and the goodwill arising. Transaction costs will be expensed. The effect of all transactions with non-controlling interests are recorded in equity if there is no change in control and these transactions will no longer result in goodwill gains and losses. The revised standard would have impacted the recording of transactions with non-controlling interests in Cymtox during 2009, with the transactions being recorded in equity rather than increasing goodwill. This may impact accounting for new investments in the future. The post balance sheet investment is not impacted as this is deemed to remain a joint venture. Effective from annual reporting periods commencing on or after 1 July 2009;
- IFRS 5 (Amendment), 'Non-current assets for sale and discontinued operations'. Clarification on disclosures. This is not expected to impact the Group. Effective for annual reporting periods commencing on or after 1 January 2010;
- IAS 1 (Amendment), 'Presentation of financial statements'. Clarification on the potential settlement of a liability by the issue of equity. This is not expected to impact the Group. Effective for annual reporting periods commencing on or after 1 January 2010;

- IAS 38 (Amendment), 'Intangible assets'. The amendment clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination. This is not expected to impact the Group. Effective for annual reporting periods commencing on or after 1 January 2010;
- IFRIC 17, 'Distributions of non-cash assets to owners'. Guidance on accounting for distribution of non-cash assets to shareholders. This is not expected to impact the Group. Effective for annual reporting periods commencing on or after 1 July 2009; and
- IFRIC 18, 'Transfers of assets from customers'. This is not expected to impact the Group. Effective for annual reporting periods commencing on or after 1 July 2009.

2.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries), associates and joint ventures.

(a) Subsidiaries

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible, are considered when assessing whether the Company controls an entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated on consolidation. Subsidiaries' accounting policies are amended where necessary to ensure consistency with the policies adopted by the Group.

(b) Associates and joint ventures

Associates are entities over which the Company has significant influence, but does not control, generally accompanied by a shareholding of 20% to 50% of the voting rights. Joint ventures are entities over which the Company exercises joint control with other parties under a formal arrangement.

Investments in associates and joint ventures are accounted for using the equity method of accounting. The cost of investment in associate undertakings and joint ventures is measured at the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange plus costs directly attributable to the transaction. The Company's investment includes goodwill identified on acquisition, net of any accumulated impairment losses.

The Group's share of its associates' and joint ventures' post-acquisition profits or losses is recognised in the statement of comprehensive income and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate or joint venture equals or exceeds its interest in the associate or joint venture, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate or joint venture.

Unrealised gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the associates and joint ventures. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates and joint ventures are changed where necessary to ensure consistency with the policies adopted by the Group.

(c) Transactions with minority interests

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the statement of comprehensive income. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

2.3 Business combinations

The purchase method of accounting is used to account for the acquisition of the Company's subsidiaries. The cost of acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued, less liabilities incurred or assumed at the date of exchange plus costs directly attributable to the transaction. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination that meet the definition under IFRS 3 Business Combinations are initially measured at their fair values at acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Company's share of the identifiable net assets is recorded as goodwill.

2.4 Goodwill

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

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

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

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

2.5 Property, plant and equipment

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

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

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

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

2.6 Intangible assets

(a) Patents

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

(b) Research and development

Expenditure on research activities is recognised as an expense in the period in which it is incurred.
Any internally-generated development costs are recognised as an asset only if all of the following are met:

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

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

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

2.7 Impairment of intangible assets, investments, property, plant and equipment
Purchased goodwill has an indefinite useful economic life, is not subject to amortisation and is tested annually for impairment as described in notes 2.4 and 15.

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

2.8 Investments
Investments are stated at cost less any provision for impairment. Investment assets are tested annually for impairment, see note 16.

2.9 Leases
Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

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

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

(b) Trade receivables
Trade receivables are amounts due from customers, joint ventures and, in the Company accounts, subsidiaries, for goods or services performed in the ordinary course of business. Trade receivables are initially recognised at fair value and subsequently measured at amortised cost.

(c) Trade payables and borrowings
Trade payables are not interest bearing and are initially measured at their fair value and subsequently measured at amortised cost. Borrowings are initially recognised at their fair value, net of transaction costs, and subsequently measured at their amortised cost.

2.11 Equity instruments
Equity instruments are recorded at fair value, being the proceeds received, net of direct issue costs.

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

(b) Share-based payments
Share-based incentive arrangements are provided to directors, employees and certain professional advisers. There are two share-based payment schemes. The Management Share Incentive Scheme (MSIS) and the Modern Water Incentive Plan (MWIP) are described in note 9.

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

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

2.13 Taxation

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

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

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

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

2.14 Revenue and income recognition

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

(a) Royalties

Royalty income is recognised as revenue on an accruals basis in accordance with the substance of the relevant agreements.

(b) Provision of goods and services

Revenue from the provision of goods and services is recognised when the risks and rewards of ownership have been transferred to the customer. The risks and rewards of ownership are deemed to have been transferred when the goods are shipped and the services provided to the customer. Income from the reimbursement of expenses by the customer is recognised in other income.

(c) Interest

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

(d) Grants

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

Grants related to income are recognised over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. Grants relating to income are recognised as other income in the statement of comprehensive income.

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

2.15 Foreign currencies

The functional and presentation currency of Modern Water plc is pounds sterling (£).

Transactions in foreign currencies are initially recorded in the functional currency by applying the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the statement of comprehensive income.

3. FINANCIAL RISK MANAGEMENT

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

- interest rate risk from variable interest rates on finance income and operating cash flow from the cash deposits. The Group's policy is to invest in fixed interest term deposits, thereby mitigating uncertainty over the future interest receipts. As the Group has no borrowings it only has limited interest rate risk;
- credit risk from placing significant deposits with counterparties. The Group's policy is to restrict counterparties to Moody's A/P1 rated and a maximum of £5m with non-rated building societies, in consultation with the Group's financial advisers. Cash balances by counterparty credit rating are listed in note 18. As Cymtox begins to generate revenue there is the associated credit risk from trade receivables. This is mitigated for consumable sales as cash is required in advance of delivery. Analyser sales are through a royalty model, where the manufacturer and distributor bears the risk of manufacturing and providing analysers which are not subsequently paid for;
- liquidity risk from cash being on deposit with counter parties and therefore not available at short notice to meet requirements. The Group's policy is to maintain rolling cash flow forecasts and place cash on deposit with a range of maturity dates to meet forecast liquidity requirements. Additionally certain deposits are redeemable in advance of the maturity date if required;
- market risk from movement in foreign currency exchange rates. The majority of the Group's costs are in pounds sterling and therefore it is appropriate to hold funds in pounds sterling; and
- capital risk addressing long term funding requirements for the Group. At the Group's current stage of development it is appropriate for it to be wholly funded by equity. As the Group develops, this capital structure will be reviewed.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

- intangibles and goodwill impairment review (see notes 2.7 and 15);
- share-based payments (see notes 2.12(b) and 9); and
- research and development cost acquired as part of a business combination (see notes 2.6(b) and 15).

5. SEGMENTAL ANALYSIS

The chief operating decision-maker is deemed to be the Board, for whom monthly financial information is provided in consolidated group format.

Revenue and gross profit during 2009 were from royalty, consumables and consultancy sales by Cymtox Limited. Other income was from the reimbursement of expenses relating to the consultancy sales.

At the Group's current stage of development the majority of the costs (business development, technical, legal, marketing, finance, facilities and directors' expenditure), including those relating to Cymtox Limited, are managed and reported centrally.

As the commercial activities of the Group develop, this financial information is expected to evolve.

6. TRANSACTIONS WITH MINORITY INTERESTS

Cymtox Limited

The Group owned 53% of the share capital of Cymtox Limited ('Cymtox') as at 1 January 2009. The Group fully consolidated Cymtox using the acquisition method of accounting for the year ended 31 December 2008.

The Group invested £600,000 cash for 195,652 new ordinary shares issued by Cymtox on 27 March 2009. The Group's shareholding correspondingly increased from 53% to 76%. The minority interest in Cymtox consequently reduced from 47% to 24%.

As this was a transaction with a minority interest a fair value exercise was not carried out. The Group has elected to use the Parent Company Method to account for the transaction.

Goodwill from the transaction was calculated as £83,000, being the difference between the consideration paid (£600,000) and the increase in carrying value (£517,000) of the Group's share of net assets (increase from £257,000 of net liabilities to 76% of £342,000 net assets).

6. TRANSACTIONS WITH MINORITY INTERESTS CONTINUED

The Group invested a further £285,000 cash for the 92,727 shares held by minority interests on 9 December 2009. The Group's shareholding correspondingly increased from 76% to 100%. The minority interest in Cymtox consequently reduced from 24% to 0%.

Goodwill from the transaction was calculated as £262,000, being the difference between the consideration paid (£285,000) and the Group's share of the carrying value of net assets acquired (£23,000).

7. ADMINISTRATIVE EXPENSES

	Note	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Employee benefits expense	8	1,826	1,831
Share-based payments	9	263	486
Depreciation, amortisation and impairment charges	14, 15, 16	429	245
Minimum lease payments recognised as an operating lease expense	22	133	128
Research and development		336	268
Auditor remuneration	10	60	66
Other administrative expenses		1,333	1,086
Total administrative expenses		4,380	4,110

8. EMPLOYEE BENEFITS EXPENSE

	Note	Year ended 31 December 2009		Year ended 31 December 2008	
		Group £000	Company £000	Group £000	Company £000
Staff costs for the year, including executive directors, amounted to:					
Wages and salaries		1,530	421	1,587	788
Social security costs		166	79	147	95
Pension costs		96	38	68	31
Other benefits		34	11	29	14
Total employee benefits expense		1,826	549	1,831	928
Equity-settled share-based payments	9	263	129	486	326
		2,089	678	2,317	1,254

	Note	Year ended 31 December 2009		Year ended 31 December 2008	
		Group Number FTE	Company Number FTE	Group Number FTE	Company Number FTE
Monthly average number of employees by activity (including executive directors):					
Executive directors		2	2	2	2
Technical		11	—	4	—
Business development		5	—	4	—
Finance, legal and administration		6	—	5	—
Total		24	2	15	2

Key management remuneration is disclosed in the directors' remuneration report on pages 15 to 17. Key management personnel are considered to be the executive directors.

The aggregate amount of emoluments paid to directors in respect of qualifying services was £649,000 (2008: £671,000). The highest paid director received £383,000 (2008: £375,000). There were no gains made by directors on the exercise of share options (2008: £nil). No money was received by directors under long term incentive schemes (2008: £nil). A cash bonus of £150,000 for the two executive directors, relating to 2009 performance, has been approved by the Remuneration Committee for payment in 2010, with the highest paid director receiving £100,000. A cash bonus of £32,500 was paid to the two executive directors in 2009, relating to 2008 performance, with the highest paid director receiving £20,000. The Remuneration Committee had not approved this at the time of the 2008 Annual Report and Accounts. £188,000 was accrued for this payment at 31 December 2008. £38,000 (2008: £31,000) was paid by the Group to the two executive directors in respect of money purchase pension schemes, with the highest paid director receiving £25,000 (2008: £21,000).

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

9. EQUITY-SETTLED SHARE-BASED PAYMENT PLANS

	Year ended 31 December 2009		Year ended 31 December 2008	
Equity-settled share-based payment plans expense	**Group £000**	**Company £000**	**Group £000**	**Company £000**
Employee benefits:				
Options	214	112	300	210
Conditional share awards	34	17	—	—
Employee bonus plan	15	—	70	—
Management share incentive scheme	—	—	116	116
Total employee benefits	263	129	486	326

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

The Company incurred £263,000 in share-based payments of which £129,000 were to its employees and a further £134,000 to the employees of subsidiary undertakings. The payment to employees of the Company's subsidiaries is recognised as a capital contribution (note 16).

9.1 Modern Water Incentive Plan (MWIP)

The MWIP was adopted on 1 June 2007 and contains provisions relating to the making of awards in the form of options, conditional awards of ordinary shares (to be received once performance conditions are satisfied) and matching awards of ordinary shares (in respect of bonuses deferred by participants) to all employees, including executive directors.

(a) Options

Under this scheme share options are granted to senior management. The exercise price is equal to the market price on the date of the grant. The options may be exercised if certain TSR performance criteria are met. If the increase is not met the options lapse.

Options over 50,000 shares were granted in the period to one employee on 21 April 2009. Additionally options over 560,877 shares lapsed due to TSR performance criteria not being achieved.

9.1 Modern Water Incentive Plan (MWIP)

(a) Options continued

The directors' and employees' holdings of options over ordinary shares issued under MWIP were as follows:

				Number of options				
Grant date	**Earliest exercise date**	**Expiry date**	**Exercise price**	**1 January**	**Granted in year**	**Exercised in year**	**Lapsed in year**	**31 December**
Neil McDougall*								
12.06.07	12.06.09	12.06.17	119.0p	186,959	—	—	186,959	—
12.06.07	12.06.10	12.06.17	119.0p	186,959	—	—	—	186,959
Simon Humphrey*								
12.06.07	12.06.09	12.06.17	119.0p	373,918	—	—	373,918	—
12.06.07	12.06.10	12.06.17	119.0p	373,918	—	—	—	373,918
Employees								
13.12.07**	13.12.10	13.12.19	97.0p	500,000	—	—	—	500,000
26.02.08**	26.02.11	26.02.20	87.5p	200,000	—	—	—	200,000
02.06.08**	02.06.11	02.06.20	112.5p	200,000	—	—	—	200,000
21.04.09***	21.04.12	21.04.19	35.0p	—	50,000	—	—	50,000
2009 Total Options				2,021,754	50,000	—	560,877	1,510,877
2009 Weighted Average Exercise Price				110p	35p	—	119p	104p
2008 Total Options				2,282,630	400,000	—	660,876	2,021,754
2008 Weighted Average Exercise Price				113p	100p	—	113p	110p

TSR performance criteria required on the earliest exercise date. If this is not met the options lapse.

* The options vest in thirds 12, 24 and 36 months from AIM admission. Each tranche vests subject to total shareholder return being at least equal to 10% for the 12 months preceding the relevant tranche vesting date.

** Options will vest subject to total shareholder return being at least equal to 30% for the three years between grant and vesting.

*** Options will vest subject to total shareholder return being at least equal to 200% for the three years between grant and vesting.

The weighted average remaining contractual life for the share options outstanding at 31 December 2009 is nine years and one month (2008: nine years and eight months). The range of exercise prices for options outstanding at the end of the year was 35p to 119p (2008: 88p to 119p). No options were exercisable as at 31 December 2009.

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

The following table lists the inputs into the model used for the options granted in the year and the prior year.

Grant date	**21 April 2009**	**2 June 2008**	**26 February 2008**
Option price	35p	113p	88p
Vesting period (years)	3.0	3.0	3.0
Assumed volatility at date of grant (historical share return volatility)	57%	36%	36%
Risk-free discount rate	3.00%	5.47%	5.47%
Expected life of option (years)	3.5	3.5	3.5
Fair value per option	11p	39p	30p
Share price at grant	35p	113p	88p

(b) Conditional share awards

The conditional share awards are provisional awards of ordinary shares in Modern Water plc, which vest three years after the date of the award on which they are made, to the extent that performance conditions have been met. The extent to which the award will vest depends on the Group's share price on the vesting date. If the share price is £1.40 or more the award will vest in full. If the share price is £1.00 or below the award does not vest at all. If the share price is between £1.00 and £1.40 the award partially vests, on the basis of 2.5% of the award for each £0.01 above a share price of £1.00.

The movement in the number of conditional shares awarded is set out below:

	2009	2008
At 1 January	—	—
Conditionally awarded during year	1,000,000	—
At December	1,000,000	—

The weighted average remaining contractual life for the conditional share awards outstanding at 31 December 2009 is two years and eight months (2008: nil). The fair value of the award is estimated as at the date of award using a Monte Carlo model, taking into account the terms and conditions upon which the shares were awarded.

The following table lists the inputs into the model used for the shares awarded in the year.

Grant date	10 September 2009
Share price at date of award	72.5p
Exercise price	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	43%
Vesting period (years)	3.0
Expected dividend yield	0%
Risk-free discount rate	2.0%
Fair value per share awarded	30p

(c) Employee Bonus Plan

The Company operates a non-contractual bonus scheme based on Company and personal performance. The Company wants to promote share ownership by employees and therefore may invite employees to waive a potential cash bonus and instead receive an award of shares in the Company.

The bonus award is an unconditional award of shares which vests after two years or before if an employee leaves. The matching award is a conditional award of shares which vests after two years for those staff still employed. The matching award is a percentage of the bonus award dependent on the total shareholder return for the two year period.

On 11 September 2008, employees were awarded a bonus based on performance in the year to 31 December 2007, to vest with any matching shares on 11 September 2010. There has been no activity in the plan during 2009. The following table illustrates the number of, and movements in, the rights to shares awarded under the scheme:

	Number of options	
	Year ended 31 December 2009	Year ended 31 December 2008
Outstanding at the beginning of the year	50,087	—
Granted during the year	—	69,081
Vested in the year	—	(18,994)
Outstanding at the end of the year	50,087	50,087

On 12 December 2008 the Group, through Modern Water (Nominees) Limited (MWNL), purchased 71,311 of the Company's ordinary 25p shares, representing 0.1% of the Company's share capital, for a consideration of £35,000 in preparation for awards due to staff under the bonus scheme. On 15 December 2008, 18,994 shares were awarded under the scheme to an employee who left the Group. The Group settled the £5,000 PAYE and NI due in cash in 2009 and transferred the net payment of 11,206 shares to the individual. MWNL consequently held 60,105 shares at 31 December 2009.

9.2 Management Share Incentive Scheme (MSIS)

The MSIS is the equity incentive scheme which directors were invited to subscribe to between 1 December 2006 and 12 March 2007. No further invitations to subscribe will be made under the MSIS. The restrictions on these shares have all been lifted. There has been no activity on the MSIS since the 2008 Annual Report and Accounts.

The holdings of ordinary shares issued under the MSIS were as follows:

	Date of subscription	Number of ordinary shares	Subscription price
Neil McDougall	1.12.06 & 12.3.07	3,363,400	0.1p
Simon Humphrey	1.12.06 & 12.3.07	1,479,000	0.1p
Gerald Jones	1.12.06	200,000	0.1p

10. AUDITOR REMUNERATION

	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Audit services fees payable to Company's auditor for the audit of parent company and consolidated financial statements	18	25
Other services:		
The audit of the Company's subsidiaries and joint venture pursuant to legislation	12	10
Tax services	30	31
Total	60	66

11. FINANCE INCOME AND COSTS

	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Finance income:		
Bank interest receivable	849	1,664
Foreign exchange gains	—	58
Total finance income	849	1,722
Finance costs:		
Foreign exchange losses	(21)	—
Total finance costs	(21)	—
Net finance income	828	1,722

12. TAXATION

12.1 Tax on loss on ordinary activities

	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Deferred tax:		
Origination and reversal of timing differences	(29)	(27)

12.2 Reconciliation of the total tax charge

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

	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Loss from operations before taxation	3,656	2,432
Accounting loss multiplied by the weighted average tax rate of 28% (period ended 31 December 2008: 28.5%)	1,024	693
Joint venture's results reported net of tax	(41)	(2)
Associate's results reported net of tax	—	(10)
Expenses not deductible for tax purposes	(100)	(135)
Capital allowances and other timing differences	(31)	(42)
Losses not utilised	(852)	(504)
Deferred tax (depreciation in excess of capital allowances)	29	27
Tax credit	29	27

The standard rate of Corporation Tax in the UK changed from 30% to 28% with effect from 1 April 2008. Accordingly, the Group's profits were taxed at an effective rate of 28% for the year ended 2009 (28.5% for year ended 31 December 2008).

12.3 Deferred tax liability

Intangible assets in business combinations	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
At 1 January	419	427
Credited to the statement of comprehensive income	(29)	(27)
Acquisition of subsidiary	—	19
At 31 December	390	419

Deferred tax liabilities arose in respect of intangible assets recognised (note 15) on the acquisitions made during the year. Deferred tax assets of £1,688,000 at 31 December 2009 (31 December 2008: £835,000) on losses have not been recognised. No deferred tax assets relating to short term timing differences or accelerated capital allowances have been recognised, due to uncertainty over the timing of the recovery of these assets.

13. LOSS PER SHARE

13.1 Basic

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

	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Loss attributable to equity holders of the Company	3,547	2,176
Weighted average number of ordinary shares in issue (thousands)	58,863	58,863
Basic loss per share	6.03p	3.70p

13.2 Diluted

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

14. PROPERTY, PLANT AND EQUIPMENT

Group	Leasehold improvements £000	Plant and machinery £000	Office equipment £000	Furniture, fixtures and fittings £000	Total £000
At 1 January 2008					
Cost	112	120	101	102	435
Accumulated depreciation	(7)	(2)	(12)	(5)	(26)
Net book amount	105	118	89	97	409
Year ended 31 December 2008					
Opening net book amount	105	118	89	97	409
Additions	7	406	37	10	460
Depreciation charge	(25)	(6)	(38)	(21)	(90)
Closing net book amount	87	518	88	86	779
At 31 December 2008					
Cost	119	526	138	112	895
Accumulated depreciation	(32)	(8)	(50)	(26)	(116)
Net book amount	87	518	88	86	779
Year ended 31 December 2009					
Opening net book amount	87	518	88	86	779
Additions	2	498	40	—	540
Depreciation charge	(24)	(72)	(53)	(22)	(171)
Closing net book amount	**65**	**944**	**75**	**64**	**1,148**
At 31 December 2009					
Cost	121	1,024	178	112	1,435
Accumulated depreciation	(56)	(80)	(103)	(48)	(287)
Net book amount	**65**	**944**	**75**	**64**	**1,148**
Company					
Cost and net book amount					
Year ended 31 December 2008					
At 1 January 2008	—	103	—	—	103
Additions	—	—	—	—	—
Disposals		(103)			(103)
At 31 December 2008	—	—	—	—	—
Year ended 31 December 2009					
At 1 January 2009 and 31 December 2009	—	—	—	—	—

There are no assets held under finance leases or hire purchase contracts at 31 December 2009 (2008: none).

15. INTANGIBLE ASSETS

Group	Goodwill £000	Patent costs £000	Development costs £000	Research and development acquired as part of a business combination £000	Total £000
At 1 January 2008					
Cost	12,042	173	57	1,620	13,892
Accumulated amortisation	—	(22)	(3)	(95)	(120)
Net book amount	**12,042**	**151**	**54**	**1,525**	**13,772**
Year ended 31 December 2008					
Opening net book amount	12,042	151	54	1,525	13,772
Additions	—	75	74	—	149
Acquisition of subsidiaries	284	17	—	70	371
Amortisation charge	—	(19)	(41)	(95)	(155)
Amortisation on acquisition of subsidiaries	—	—	—	(2)	(2)
Closing net book amount	**12,326**	**224**	**87**	**1,498**	**14,135**
At 31 December 2008					
Cost	12,326	265	131	1,690	14,412
Accumulated amortisation	—	(41)	(44)	(192)	(277)
Net book amount	**12,326**	**224**	**87**	**1,498**	**14,135**
Year ended 31 December 2009					
Opening net book amount	12,326	224	87	1,498	14,135
Additions	—	100	—	—	100
Transaction with minority interest	345	—	—	—	345
Amortisation charge	—	(22)	(43)	(103)	(168)
Closing net book amount	**12,671**	**302**	**44**	**1,395**	**14,412**
At 31 December 2009					
Cost	12,671	365	131	1,690	14,857
Accumulated amortisation	—	(63)	(87)	(295)	(445)
Net book amount	**12,671**	**302**	**44**	**1,395**	**14,412**

Transactions with the minority interest shareholders in Cymtox Limited resulted in an increase in goodwill during the year ended 31 December 2009, see note 6.

The acquisition of Cymtox Limited gave rise to the recognition of goodwill and intangible assets during the year ended 31 December 2008. The acquisitions of Surrey Aquatechnology Limited and Poseidon Water Limited gave rise to the recognition of goodwill and intangible assets brought forward at 1 January 2008.

Additions to patent costs arise from legal and other fees incurred in securing patents.

Additions to development costs arise from costs incurred once there is sufficient certainty over the technical feasibility and commercial viability of the underlying technology.

15. INTANGIBLE ASSETS CONTINUED

The goodwill carrying value by CGU is summarised below:

Group	2009 £000	2008 £000
Surrey Aquatechnology Limited	11,902	11,902
Poseidon Water Limited	140	140
Cymtox Limited	629	284
	12,671	12,326

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

The goodwill impairment review indicated that the recoverable amounts are in excess of the carrying value and therefore there was no goodwill impairment recorded in the year.

The recoverable amount is determined using value in use calculations. The use of this method requires the estimation of future cash flows before tax and the selection of a suitable discount rate in order to calculate the present value of these cash flows.

Modern Water is in a development phase, prior to securing revenue generating contracts. Therefore the cash flow calculations analyse the present value of applying Modern Water's patented Manipulated Osmosis, wastewater and toxicity monitoring technology to potential contracts in the future. The estimated recoverable amounts achievable on a small number of contracts would exceed the carrying value of the assets.

There is sufficient headroom between the recoverable amount and carrying value to allow for movement in the key assumptions before impairment is required.

The key assumptions for the Surrey Aquatechnology Limited value in use calculation are the securing of future commercial contracts and delivery of opex and capex savings for MOD plants compared with traditional desalination technology. Management estimate these savings based on trial results from the operational pilot plants. The value in use calculation uses a 20 year timeframe consistent with the industry standard for Build Own Operate Transfer (BOOT) contracts.

The key assumption for the Cymtox Limited value in use calculation is the sales volume. Management estimate the sales volume based on the 2010 budget, which was approved by the Board, and extrapolation of cash flows over the next five years.

The key assumption for the Poseidon Water Limited value in use calculation is the securing of targeted wastewater contracts on major construction projects over the next five years.

A discount rate of 10% (2008: 10%) has been used for all value in use projections. All assumptions have been reviewed at the end of the year and revised where necessary.

Company

There were no intangible assets recognised in the Company's statement of financial position at 31 December 2009 (2008: none).

16. INVESTMENTS

Group	Investment in associate £000	Investment in joint venture £000	Other investments £000	Total £000
Year ended 31 December 2008				
Opening book amount	167	—	90	257
Additions	—	400	—	400
Share of loss	(35)	(9)	—	(44)
Transfer to subsidiary	(132)	—	—	(132)
Closing net book amount	—	391	90	481
Year ended 31 December 2009				
Opening book amount	—	391	90	481
Share of loss	—	(145)	—	(145)
Impairment	—	—	(90)	(90)
Closing net book amount	**—**	**246**	**—**	**246**

Company	Investment in subsidiary £000	Investment in associate £000	Investment in joint venture £000	Other investments £000	Total £000
Year ended 31 December 2008					
Opening book amount	13,769	167	—	90	14,026
Capital contribution relating to share-based payment	160	—	—	—	160
Additions	150	—	400	—	550
Reclassification	167	(167)	—	—	—
Closing book amount	14,246	—	400	90	14,736
Year ended 31 December 2009					
Opening book amount	14,246	—	400	90	14,736
Capital contribution relating to share-based payment	134	—	—	—	134
Addition	885	—	—	—	885
Impairment	—	—	—	(90)	(90)
Closing book amount	**15,265**	**—**	**400**	**—**	**15,665**

Subsidiary and joint venture undertakings, which contribute to the Group result	Principal activities	% Shareholding	Status
Modern Water Services Limited	Technical, business development, finance, legal and admin services to the Group companies	100	Subsidiary
Surrey Aquatechnology Limited	Desalination technology	100	Subsidiary
Modern Water (Nominees) Limited	Acquisition and allocation of share-based payments for the Group	100	Subsidiary
Cymtox Limited	Toxicity monitoring applications	100	Subsidiary
Poseidon Water Limited	Saline wastewater treatment systems	51	Subsidiary
AguaCure Limited	Electro-coagulation wastewater treatment systems	45	Joint Venture

All subsidiaries and joint ventures are incorporated in Great Britain. Shares held are all ordinary share capital.

16. INVESTMENTS CONTINUED

Investment in subsidiary

See note 6 'Transactions with minority interests' for detail on the Group's increase in investment in Cymtox Limited.

Investment in joint venture

During the year, AguaCure Limited recorded a loss of £323,000 (2008: £42,000). The Group's share of the loss was £145,000 (2008: £9,000). The loss resulted from income of £149,000 (2008: £12,000) and expenses of £472,000 (2008: £54,000).

At 31 December 2009, AguaCure Limited had current assets of £117,000 ((2008: £429,000), fixed assets of £41,000 (2008: £1,000), current liabilities of £119,000 (2008: £58,000) and long term liabilities of £5,000 (2008: £13,000). The Group's share of assets was £71,000 (2008: £193,000) and its share of liabilities was £56,000 (2008: £32,000).

The investment at 31 December 2009 of £246,000 (2008: £391,000) represents the £400,000 fair value on acquisition less £154,000 share of post acquisition losses.

Other investments

Other investments comprise a shareholding in Stonybrook Purification Inc., a company incorporated in the USA. The carrying value of this investment has been impaired and reduced to zero as at 31 December 2009 to reflect that during January 2010 the Company filed for voluntary dissolution.

17. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2009 £000	2008 £000	2009 £000	2008 £000
Trade receivables	44	1	—	—
Value added tax and social security	62	52	17	1
Accrued income	297	323	297	323
Other receivables	4	2	—	—
Amounts due from subsidiary undertakings	—	—	5,474	2,664
Amounts due from joint venture undertakings	12	22	—	21
Prepayments	138	118	27	12
	557	518	5,815	3,021

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

18. CASH
18.1 Cash and cash equivalents

Cash and cash equivalents	Group 2009 £000	Group 2008 £000	Company 2009 £000	Company 2008 £000
Cash at bank	1,523	1,698	1,456	1,622
Short-term deposits	21,600	25,157	21,600	25,157
Cash at bank and in hand	23,123	26,855	23,056	26,779

18.2 Credit quality of cash and cash equivalents

		2009 £000	2008 £000
Short term	Long term		
P-1	AAA	—	—
P-1	AA	11,523	14,855
P-1	A	9,000	12,000
Non-rated	Non-rated	2,600	—
		23,123	26,855

The credit quality of the cash and cash equivalents is assessed using Moody's short and long term ratings. Non-rated is where the counterparty has not been required to obtain a rating as they have no commercial paper issued in public markets, these counterparties are building societies.

19. TRADE AND OTHER PAYABLES

Current	Group 2009 £000	Group 2008 £000	Company 2009 £000	Company 2008 £000
Trade payables	175	164	81	22
VAT and social security	47	41	19	19
Accruals	793	746	187	251
	1,015	951	287	292

20. BORROWINGS

Current	Group 2009 £000	Group 2008 £000	Company 2009 £000	Company 2008 £000
Loans	—	8	—	—

The loan with Finance Wales plc was repaid in full during 2009. Whilst repayments were on time, no interest was payable. It was unsecured.

21. FINANCIAL INSTRUMENTS BY CATEGORY

The accounting policies for financial instruments have been applied to the line items below. The fair value of the assets and liabilities is equal to their carrying value. No trade receivables were overdue at the balance sheet date.

	Year ended 31 December 2009		Year ended 31 December 2008	
Group	**Loans and receivables (£000)**	**Total (£000)**	**Loans and receivables (£000)**	**Total (£000)**
Assets as per statement of financial position				
Trade and other receivables*	419	419	400	400
Cash and cash equivalents	23,123	23,123	26,855	26,855
Total	23,542	23,542	27,255	27,255

	Other financial liabilities (£000)	Total (£000)	Other financial liabilities (£000)	Total (£000)
Liabilities as per statement of financial position				
Borrowings	—	—	8	8
Trade and other payables**	968	968	910	910
Total	968	968	918	918

	Year ended 31 December 2009		Year ended 31 December 2008	
Company	**Loans and receivables (£000)**	**Total (£000)**	**Loans and receivables (£000)**	**Total (£000)**
Assets as per statement of financial position				
Trade and other receivables*	5,788	5,788	3,009	3,009
Cash and cash equivalents	23,056	23,056	26,779	26,779
Total	28,844	28,844	29,788	29,788

	Other financial liabilities (£000)	Total (£000)	Other financial liabilities (£000)	Total (£000)
Liabilities as per statement of financial position				
Trade and other payables**	268	268	273	273
Total	268	268	273	273

* excludes prepayments

** includes accruals, but excludes any statutory liabilities

Included in the cash and cash equivalents of the Group and Company at 31 December 2009 was the equivalent of £183,000 (2008: £218,000) denominated in US dollars. The balance was denominated in pounds sterling (£).

Included in the trade receivables of the Group at 31 December 2009 was the equivalent of £30,000 (2008: £nil) denominated in euros. The balance was denominated in pounds sterling (£).

Neither the Group nor the Company currently have a requirement for bank facilities.

22. COMMITMENTS AND CONTINGENCIES

22.1 Group operating leases

Future aggregate minimum lease payments under non-cancellable operating leases as at 31 December 2009 are as follows:

	Group		Company	
	2009 £000	2008 £000	2009 £000	2008 £000
Not later than one year	160	158	—	—
After one year but not more than five years	246	397	—	—
	406	555	—	—

The Group's operating leases relate to property and office equipment, and have remaining terms of between two and three years. The amount recognised as an expense in the year is £133,000 (2008: £128,000).

22.2 Capital commitments

The Company had no contracted but not provided capital commitments as at 31 December 2009 (2008: £232,000). The prior year capital commitment related to plant and equipment.

22.3 Contingent liabilities

The Group had no unprovided contingent liabilities at the balance sheet date (2008: £nil).

23. CALLED UP SHARE CAPITAL

Ordinary shares of 0.25p each	2009 Number	2008 Number	2009 £000	2008 £000
Authorised	100,000,000	100,000,000	250	250
Allotted and fully paid	58,862,685	58,862,685	147	147

The Group, through Modern Water (Nominees) Limited (MWNL), held 60,105 shares at 31 December 2009 (2008: 60,105) for future share-based payment obligations, see note 9.1(c).

24. NET CASH FLOWS FROM OPERATING ACTIVITIES

		Year ended 31 December 2009		Year ended 31 December 2008	
	Note	Group £000	Company £000	Group £000	Company £000
Operating loss		(4,339)	(1,086)	(4,110)	(1,420)
Adjustments for:					
Depreciation of property, plant and equipment	14	171	—	90	—
Amortisation of intangible assets	15	168	—	155	—
Impairment of investment	16	90	90		
Equity-settled share-based payments	9	263	129	486	326
Movements in working capital:					
(Increase)/Decrease in trade and other receivables	17	(65)	(2,820)	87	(1,925)
Increase/(Decrease) in trade and other payables	19	64	(5)	285	(24)
Cash used in operations		(3,648)	(3,692)	(3,007)	(3,043)

25. RELATED PARTY TRANSACTIONS

IP Group plc holds 23.19% of the ordinary share capital of the Company and appoints a non-executive director, it is therefore deemed a related party. A service agreement dated 1 December 2006 was made between the Company and IP Group plc, whereby IP Group plc provides strategic, business development and administrative services to the Company for a consideration of £60,000 per annum. This was reduced to £30,000 per annum from 1 March 2009. Fees for the year were £35,000 and as at 31 December 2009 £7,500 (31 December 2008: £15,000) was outstanding under this agreement.

Transactions with the Group's joint venture AguaCure Limited are recorded using the equity method of accounting and not eliminated on consolidation and therefore require disclosure in the Group accounts. Modern Water Services Limited provided technical, management and business development services at cost to AguaCure during 2009 for fees of £99,000 (31 December 2008: £nil). These fees are recorded as a credit to administrative costs and form part of the Group's share of AguaCure's loss in the statement of comprehensive income.

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

An agreement dated 30 November 2006 was made between the Company and Surrey Aquatechnology Limited for the provision of administrative services for fees of £6,000 per annum. At 31 December 2009, fees of £6,000 (31 December 2008: £6,000) were outstanding under this agreement.

An agreement dated 14 December 2006 was made between the Company and Cymtox Limited for the provision of administrative services for fees of £14,463 per annum. At 31 December 2009, fees of £1,000 (31 December 2008: £17,000) were outstanding under this agreement.

An agreement dated 14 December 2006 was made between the Company and Poseidon Water Limited for the provision of administrative services for fees of £50,760 per annum. At 31 December 2009, fees of £55,000 (31 December 2008: £55,000) were outstanding under this agreement.

Additionally the Company had receivable balances at 31 December 2009 with its subsidiary companies to fund working capital as follows:
- Surrey Aquatechnology Limited – £568,000 (31 December 2008: £162,000);
- Cymtox Limited – £2,000 (31 December 2008: £29,000);
- Poseidon Water Limited – £36,000 (31 December 2008: £6,000);
- Modern Water (Nominees) Limited – £40,000 (31 December 2008: £35,000); and
- Modern Water Services Limited – £4,766,000 (31 December 2008: £2,354,000).

26. POST BALANCE SHEET EVENTS

At 31 December 2009, Modern Water plc owned 45% of AguaCure Limited (AguaCure), which it accounted for as a joint venture. On 5 February 2010, Modern Water plc invested £100,000 for 20 newly issued AguaCure shares. This increased the Group's shareholding to 54%.

NOTICE OF ANNUAL GENERAL MEETING

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. IF YOU ARE IN ANY DOUBT AS TO ANY ASPECT OF THE CONTENTS OF THIS DOCUMENT OR THE ACTION YOU SHOULD TAKE YOU ARE RECOMMENDED TO CONSULT AN INDEPENDENT ADVISOR AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000.

Notice is hereby given that the Annual General Meeting of Modern Water plc will be held at the offices of the Company, Bramley House, The Guildway, Old Portsmouth Road, Guildford, Surrey GU3 1LR, on 20 April 2010 at 10.00am to consider and, if thought fit, pass the following resolutions, of which resolutions 1 to 6 will be proposed as ordinary resolutions, and resolutions 7 to 9 will be proposed as special resolutions.

ORDINARY RESOLUTIONS

1. To receive and adopt the directors' report, the accounts and the Auditors' report for the financial year ended 31 December 2009.

2. To approve the directors' remuneration report for the year ended 31 December 2009.

3. To reappoint PricewaterhouseCoopers LLP as Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next general meeting of the Company at which accounts are laid before the shareholders, and to authorise the directors to fix their remuneration.

4. To re-elect Mr Michael Gradon, who retires by rotation, as a director of the Company.

5. To re-elect Mr Mike Townend, who retires by rotation, as a director of the Company.

6. THAT the directors be generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 ('the Act') to exercise all the powers of the Company to allot equity securities (as defined in section 560 of the Act):

   (a) up to an aggregate nominal amount of £49,052 (being one-third of the nominal value of the issued share capital of the Company as at 9 March 2010); and in addition:

   (b) up to a further aggregate nominal amount of £49,052 (being one-third of the nominal value of the issued share capital of the Company as at 9 March 2010) in connection with a rights issue in favour of holders of shares in proportion, as nearly as is practicable, to their existing holding, and holders of other equity securities (to the extent that this is required by the rights of those securities or is permitted by those rights and considered necessary by the directors), subject only to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates, shares represented by depositary receipts, legal or practical difficulties arising under the laws of any territory or the requirements of any relevant regulatory body or any stock exchange, or any other matter.

   This authority shall operate in substitution for and to the exclusion of any previous authority given to the directors pursuant to section 80 of the Companies Act 1985, and shall expire on the conclusion of the Company's 2011 Annual General Meeting (or if earlier 20 July 2011), except that the Company may before such expiry make any offer or agreement which would or might require relevant securities to be allotted after such expiry and, notwithstanding such expiry, the directors may allot relevant securities pursuant to any such offer or agreement.

SPECIAL RESOLUTIONS

7. THAT subject to the passing of resolution 6 the directors be empowered in accordance with section 571 of the Companies Act 2006 ('the Act') to allot equity securities (as defined in section 560 of the Act), payment for which is to be wholly in cash, pursuant to the authority conferred by resolution 6 as if section 561 of the Act did not apply to any such allotment provided that this power shall be limited to:

   (a) the allotment of equity securities in connection with a rights issue, or any other pre-emptive offer, in favour of holders of shares in proportion, as nearly as is practicable, to their existing holding, and holders of other equity securities (to the extent that this is required by the rights of those securities or is permitted by those rights and considered necessary by the directors), subject only to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates, shares represented by depositary receipts, legal or practical difficulties arising under the laws of any territory or the requirements of any relevant regulatory body or any stock exchange, or any other matter; and,

NOTICE OF ANNUAL GENERAL MEETING
CONTINUED

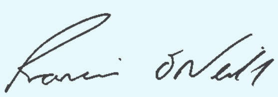
(b) the allotment (otherwise than pursuant to sub-paragraph (a) above) of equity securities up to an aggregate nominal value of £7,357.84 (being 5% of the nominal value of the issued share capital of the Company as at 9 March 2010).

This power shall operate in substitution for and to the exclusion of any previous power given to the directors pursuant to section 95 of the Companies Act 1985 and shall expire at the same time as the authority in resolution 6, except that the Company may before such expiry make any offer or agreement which would or might require equity securities to be allotted after such expiry and, notwithstanding such expiry, the directors may allot equity securities pursuant to any such offer or agreement.

8. THAT with immediate effect the Articles of Association produced to the meeting and initialled by the Chairman of the meeting for the purpose of identification be adopted as the Articles of Association of the Company in substitution for, and to the exclusion of, the existing Articles of Association (including all the provisions of the Company's Memorandum of Association which, by virtue of section 28 Companies Act 2006, are to be treated as provisions of the Company's Articles of Association).

9. THAT a general meeting of the Company other than an Annual General Meeting may be called on not less than 14 clear days' notice.

By order of the Board



FRANCIS O'NEILL
Company Secretary
10 March 2010
Modern Water plc
Registered in England and Wales Number 5963927

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

NOTES

1. Members are entitled to appoint a proxy to exercise all or any of their rights to attend and to speak and vote on their behalf at the meeting. A shareholder may appoint more than one proxy in relation to the Annual General Meeting provided that each proxy is appointed to exercise the rights attached to a different share or shares held by that shareholder. A proxy need not be a shareholder of the Company. A proxy form to make such appointment and give proxy instructions accompanies this notice. If you do not have a proxy form and believe that you should have one, or if you require additional forms, please contact the Company's registrars, Capita Registrars on 0871 664 0300 (calls cost 10p per minute plus network extras) or, if telephoning from overseas, on +44 208 639 3399. Lines are open 8.30am – 5.30pm GMT Monday to Friday.

2. To be valid any proxy form or other instrument appointing a proxy must be received by post or (during normal business hours only) by hand not less than 48 hours before the time fixed for the meeting.

3. The return of a completed proxy form, other such instrument or any CREST Proxy Instruction (as described in paragraph 8 below) will not prevent a shareholder attending the Annual General Meeting and voting in person if he/she wishes to do so.

4. Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a 'nominated person') may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a nominated person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.

5. The statement of the rights of shareholders in relation to the appointment of proxies in paragraph 1 above does not apply to nominated persons. The rights described in that paragraph can only be exercised by shareholders of the Company.

6. To be entitled to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast), shareholders must be registered in the register of members of the Company at 6.00pm on 18 April 2010 or, if the meeting is adjourned, 48 hours prior to the time fixed for the adjourned meeting. Changes to the register of members after that time shall be disregarded in determining the right of any person to attend and vote at the meeting.

7. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

8. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with CRESTCo's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an ; to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10). For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

9. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that CRESTCo does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member, or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

10. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

11. As at 10.00am on 9 March 2010 (being the day on which the Board approved this notice) the Company's issued share capital consisted of 58,862,685 ordinary shares, carrying one vote each. Therefore the total voting rights in the Company as at that time were 58,862,685.

FORM OF PROXY MODERN WATER PLC

COMPANY NUMBER: 5963927

Please read carefully the notice of meeting and explanatory notes set out below before completing this form.

Please complete this form in BLOCK CAPITALS.

I/We (name)..

of (address)..

....

being a member(s) of the above named Company hereby appoint the Chairman of the meeting or (see notes 1, 5 and 7)

(name)..

of (address)..

as my/our proxy to vote for me/us and on my/our behalf at the Annual General Meeting of the Company to be held at the offices of the Company, Bramley House, The Guildway, Old Portsmouth Road, Guildford GU3 1LR at 10.00am on 20 April 2010 and at any adjournment thereof.

I/we direct my/our proxy to vote as indicated by an 'X' in the appropriate column (note 2).

Ordinary resolutions	**For**	**Against**	**Withheld**
1. To receive and adopt the directors' report, the audited statement of accounts and Auditors' report of the Company for the financial year ended 31 December 2009			
2. To receive and approve the directors' remuneration report for the year ended 31 December 2009			
3. To reappoint PricewaterhouseCoopers LLP as Auditors of the Company and to authorise the directors of the Company to fix their remuneration			
4. To re-elect Michael Gradon as a director of the Company, who is retiring by rotation and offering himself for re-election			
5. To re-elect Mike Townend as a director of the Company, who is retiring by rotation and offering himself for re-election			
6. To authorise the directors to allot equity securities up to a nominal amount of £49,052, and in addition, by way of fully pre-emptive rights issue, up to a nominal amount of £49,052			
Special resolutions	**For**	**Against**	**Withheld**
7. To authorise the directors to allot equity securities for cash, disapplying the statutory pre-emption rights, up to a nominal amount of £7,357.84 (being 5% of the issued capital)			
8. To adopt new Articles of Association			
9. To call a general meeting (other than AGM) on not less than 14 days' notice			

Signature(s) and/or common seal (notes 3 and 4)..

....

Date.. 2010

Notes

1. A proxy need not be a member of the Company. Completion and return of this form of proxy does not preclude a member from subsequently attending and voting at the meeting. If you wish to appoint a proxy other than the Chairman of the meeting, please cross out the words 'the Chairman of the meeting or' and write the full name and address of your proxy in the space provided. The change should be initialled.
2. If you do not indicate how you wish your proxy to vote on any resolution or on any other matter (including any amendment to any resolution), the proxy will exercise his/her discretion as to how he/she votes and as to whether or not he/she abstains from voting in such manner as he/she thinks fit.
3. This form must be signed and dated by the shareholder or his/her attorney duly authorised in writing. In the case of a corporation this form of proxy must be executed under its common seal or under the hand of an officer or attorney duly authorised in writing.
4. A form of proxy, to be valid, must be signed and dated and must be lodged, together with the power of attorney or other authority (if any) under which it is signed, or a duly certified copy of such power or authority, with the Company's registrars, Capita Registrars at: Capita Registrars PXS 34, Beckenham, Kent BR3 4TU not less than 48 hours before the time fixed for the meeting.
5. In the case of joint holders, the signature of any one of them will suffice but the names of all joint holders should be stated. The vote of the senior who tenders a vote (whether in person or by proxy) will be accepted to the exclusion of the votes of the other holders. For this purpose, seniority is determined by the order in which the names stand in the register of members in respect of the joint holding.
6. Any alteration to this form must be initialled.
7. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting is 6.00pm on 18 April 2010 or, if the meeting is adjourned, 48 hours prior to the time fixed for the adjourned meeting. Changes to the register of members after that time shall be disregarded in determining the right of any person to attend and vote at the meeting.

third fold and tuck in

first fold

Business Reply
Licence Number
RSBH-UXKS-LRBC

1

PXS
34 Beckenham Road
BECKENHAM
BR3 4TU

second fold

REGISTERED OFFICE

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

COMPANY NUMBER

Registered in England and Wales number 5963927

Further details can be found on the Modern Water website: www.modernwater.co.uk

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London EC2V 8AE

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Chartered Accountants and Statutory Auditors
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Gatwick
West Sussex RH6 0PP

SOLICITORS

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London SE1 2AQ

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The Registry
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Beckenham BR3 4TU

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Registered number: 5963927

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